Supreme Court, U. S.
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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1977

No. 77-1620

FIRST NATIONAL BANK AND TRUST COMPANY IN ALTON,
Executor of the Estate of Joseph E. Knight,
Petitioner,

vs.

SAMUEL BERKE, Receiver of City Savings Association,
Respondent.

APPENDIX SUPPORTING PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

J. F. SCHLAFLY
P. O. Box 190
Alton, Illinois 62002
(618) 465-7733

RAYMOND F. McNALLY, JR.
611 Olive Street
St. Louis, Missouri 63101
(314) 621-1614

EDWARD S. MACIE
111 West Washington Street
Chicago, Illinois 60603
(312) 372-6242

Attorneys for Petitioner

St. Louis Law Printing Co., Inc., 812 Olive Street 63101 314-231-4477

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APPENDIX A

In the
United States Court of Appeals
for the Seventh Circuit

No. 77-1582

Alexander Tcherepnin, et al.,

Plaintiffs,

v.

Robert Franz, et al.,

Defendants.

Samuel Berke, Receiver of City Savings Association,

Cross-Plaintiff, Appellee,

v.

First National Bank and Trust Company in Alton, Executor of the Estate of Joseph E. Knight,

Cross-Defendant, Appellant.

Appeal from the United States District Court for the
Northern District of Illinois, Eastern Division
No. 64 C 1285—Edwin A. Robson, Judge

Argued October 26, 1977—Decided January 23, 1978

Before Swygert, Cummings and Bauer, Circuit Judges.

Bauer, Circuit Judge. This appeal represents the latest stage in the complex and protracted litigation spawned by the 1964

collapse of the City Savings Association, a Chicago-based savings and loan institution. Styled by the district court as a "chronicle of political intrigue and corruption perhaps unmatched in Illinois history," the failure of City Savings was in no small measure the handiwork of its president and director, C. Oran Mensik, who milked the association of millions of dollars through inflated mortgage loans and other fraudulent schemes. The central figure in this case, however, is Joseph Knight, Director of the Illinois Department of Financial Institutions from 1962 to 1968. More specifically, in this appeal, the Estate of Knight challenges the district court's finding that Knight was liable to the depositors of City Savings for his official conduct in connection with the association's demise. Before turning to a consideration of the appellant's arguments, however, we must first review the factual and statutory background of the proceedings below.

I. Background

Because the history of this affair is fully set forth in the lower court's opinion, *Tcherepnin v. Franz*, 393 F. Supp. 1197 (1975), we need only briefly recount the central events in both the collapse of City Savings and the litigation that it engendered.

After encountering a serious capital impairment which prompted the State of Illinois to close its doors, the City Savings Association was reopened to the public on December 19, 1957. The association remained under judicial supervision until 1959 when, under the direction of its president and director, C. Oran Mensik, it embarked upon an aggressive promotional campaign to attract new depositors. From 1959 to 1964, it is now clear, the affairs of City Savings were not conducted in accordance with the provisions of the Illinois Savings and Loan Act. Most importantly —and these facts are not in dispute—City Savings made loans of more than $21,000,000 to entities controlled by Mensik or his nominees, loans that were "secured" by fraudulently overvalued

property in the so-called "Apple Orchard" and "Howie-in-the-Hills" development projects.[1] These inflated mortgage loans, together with several other illegal acts of mismanagement,[2] left City Savings in a precarious financial condition with a capital impairment of more than $14,000,000.

Although the Department of Financial Institutions began examining the affairs of City Savings in January 1964, it was not until June of that year, when an independent audit conducted by Peat, Marwick, Mitchell & Co. revealed the full extent of City Savings' capital impairment, that Joseph Knight, Director of the Department of Financial Institutions, closed the association. Following the closing, in a meeting held on July 28, 1964, the depositors of City Savings approved a plan of voluntary liquidation which placed the assets of the association in the hands of three voluntary liquidators, one nominated by Mensik and the other two by the State of Illinois.

The beginning of the lengthy litigation that followed the association's collapse came on July 29, 1964, when Alexander Tcherepnin and other holders of withdrawable capital shares of City Savings filed a complaint alleging that various state officials, the voluntary liquidators and others had violated the Securities Exchange Act of 1934.[3] When the plaintiffs subsequently moved for the appointment of a receiver, Judge Camp-

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[1] When City Savings was closed on June 30, 1964, the outstanding net unpaid balance of the Apple Orchard loans was $14,827,415.20 and the outstanding net unpaid balance of the Howie-in-the-Hills loans was $5,675,047.14. *Tcherepnin v. Franz*, 316 F. Supp. 714, 718 (N.D. Ill. 1970). A subsequent appraisal indicated that the true value of the subdivision properties was $6,391,751.31.

[2] See discussion *infra* at (A. 8-10).

[3] On December 18, 1967, the Supreme Court held that the plaintiffs' withdrawable shares were "securities" within the meaning of the Securities Exchange Act of 1934, 15 U.S.C. § 78(a) et seq. *Tcherepnin v. Knight*, 389 U.S. 332 (1967).

bell, finding the state-supervised plan of voluntary liquidation to be "tainted with fraud from its inception," entered an order terminating the liquidation and appointing two receivers for the association.

The receivers proceeded to file their First Cross-Complaint on January 15, 1969, which, as amended, charged named state officials, including Joseph Knight, with breaching their statutory duties to City Savings, thereby rendering themselves, the State of Illinois and their surety liable for damages to the depositors. In the course of the subsequent litigation, the State and the receivers entered into settlement negotiations which culminated in the legislative appropriation of $12,467,500 for the reimbursement of the City Savings depositors. The receivers then filed a motion for summary judgment against the remaining cross-defendants on November 5, 1973. On April 14, 1975, the district court granted summary judgment on Counts I and II of the receivers' complaint against the Knight Estate, finding (1) that Joseph Knight had maliciously breached a statutory duty to supervise the affairs of City Savings; and (2) that Knight had either fraudulently participated in foisting the illegal plan of voluntary liquidation upon the City Savings depositors, or, alternatively, negligently breached certain ministerial duties in connection with the adoption of that plan. It is from this judgment that the Estate now appeals.

II. The Statutory Framework

Counts I and II of the receivers' complaint were premised on certain statutory duties imposed on the Director of the Department of Financial Institutions by the Illinois Savings and Loan Act, Ill. Rev. Stat. ch. 32, §§ 701-944 (1963). In essence, the Act charges the Department of Financial Institutions and its Director with supervising the affairs of all savings and loan associations within the state to insure that those businesses are operated "only by associations organized and conducted

in accordance with the authority provided in this Act." Ill. Rev. Stat., ch. 32, § 702(b) (1963). To this end, Section 842 of the Act gives the Director access to the books of every savings and loan association within the state and requires him to conduct an examination of every association at least once a year. That same section also empowers the Director to require the officers and directors of any association that is not conducting its business in accordance with the Act to take corrective action. In addition, Section 843 empowers the Director to order, without prior notice, an audit of the books of any association, while Section 844 requires every association to file with the Department of Financial Institutions a statement of its financial condition at the close of the fiscal year. Finally, under Section 848, the Director is empowered to take custody of the books, records and assets of any association if, among other reasons, the association's capital is seriously impaired, or its business is being conducted in a "fraudulent, illegal, or unsafe manner."

In sum, then, the comprehensive powers granted to the Director of the Department of Financial Institutions are all designed to enable him to supervise the affairs of savings and loan associations within the State of Illinois, and thus insure that every association is being conducted in accordance with the provisions of the Illinois Savings and Loan Act. With this in mind, we now turn to the appellant's arguments.

III. Count I

The Knight Estate's initial argument on appeal invokes the doctrine of official immunity. Pointing to Knight's special status as a public official, and citing state and federal decisions endorsing the policy of official immunity, the Estate claims that Knight acted within the scope of his statutory authority in the years 1962-1964, and was thus immune from liability to the City Savings depositors.

It is true that a widely accepted principle of the common law holds that public officials are immune from liability for errors in judgment in the performance of their duties. See *Nagle v. Wakey*, 161 Ill. 387, 392-94, 43 N.E. 1079, 1081 (1896). But in Illinois, as in other jurisdictions, the immunity conferred on public officials is a qualified one, one that is displaced by an official's negligent conduct in the performance of ministerial duties or malicious and corrupt conduct in the performance of discretionary duties. *People* ex rel. *Munson v. Bartels*, 138 Ill. 322, 27 N.E. 1091 (1891). Clearly, then, Knight was not immune from liability if, as the lower court found, he maliciously breached a discretionary duty to supervise the affairs of City Savings. By the same token, Knight was not immune from liability if, as the court also found, he negligently breached certain ministerial duties in permitting the adoption of the plan of voluntary liquidation.

In this connection, however, the Estate makes two additional claims: first, that Knight's statutory duties were owed only to the public-at-large—that is, to the State of Illinois—and not to the depositors of City Savings; and second, that Count I of the receivers' complaint did not allege Knight's conduct to be "malicious" or "corrupt." Neither argument is persuasive. While we agree that official misconduct can constitute an individual wrong only if a duty is owed to the party seeking redress, *People of the State of Illinois v. Maryland Casualty Co.*, 132 F.2d 850 (7th Cir. 1942), we find nothing in the Illinois Savings and Loan Act to suggest that Knight was charged with responsibilities only to the State of Illinois. On the contrary, the Act, by making repeated references to the "protection of the Association" in defining the duties of the Director,[4] indicates that the Association—and, more specifically, its depositors—have a vested right in the duties therein prescribed. See *Mills v. American Surety Co. of New York*, 26 Idaho 652, 145 P. 1097 (1914).

[4] See e.g., Ill. Rev. Stat. ch. 32, §§ 747, 848 (1963).

Nor can we agree that Count I of the receivers' complaint charged Knight with mere negligence in the performance of discretionary duties. The complaint, it is true, did not specifically characterize Knight's conduct as "malicious" or "corrupt." But this can be of no significance if the allegations necessarily entail malicious conduct, that is, the wanton and deliberate commission of a wrongful act.[5] See *State v. Dixon*, 80 Kan. 650, 103 P. 130 (1909). Such is the case here, for to allege, as the plaintiffs did, that Knight intentionally ignored or concealed examinations indicating that City Savings was not conducting its business in accordance with the Illinois Savings and Loan Act is necessarily to claim that Knight willfully and wantonly—in short, "maliciously"—breached his official duty to supervise the affairs of that institution. Thus, it is our conclusion that Joseph Knight, as Director of the Department of Financial Institutions for the State of Illinois, owed a statutory duty to the depositors of City Savings; that the intentional breach of that duty would constitute a malicious act; and that such malicious conduct would override his qualified immunity as a public official.

The central question posed by Count I, then, is whether the district court was correct in finding that the evidence could support but one conclusion, namely, that Joseph Knight did in fact maliciously disregard his statutory duty to supervise the affairs of City Savings. On this point, the Estate argues that Knight's conduct prior to taking custody of City Savings was reasonable in light of the written reports that were available to him on City Savings' financial condition. In particular, the Estate emphasizes that the examinations of three independent auditors conducted in late 1963 and early 1964 all showed City Savings to be solvent. And, according to the Estate, it was not until June

[5] For definitions of "malice," see *Fromm v. Seyller*, 245 Ill. App. 392 (2d Dist. 1927); *Kaplan v. Williams*, 245 Ill. App. 542 (1st Dist. 1927); *Smith v. Moran*, 43 Ill. App. 2d 373, 193 N.E.2d 466 (2d Dist. 1967).

1964, shortly before Knight took custody of City Savings, that he received a written report (the Peat, Marwick audit) indicating the capital impairment of more than $14,000,000.

This argument, however, proceeds on the assumption that the auditors' reports of solvency, all of which accepted as true the grossly inflated book values of property owned by City Savings, somehow neutralized the mounting evidence of massive irregularities, which, according to the undisputed testimony of state officials including Knight himself, came to the Director from other sources. Perhaps most important in this regard were the reports of Justin Hulman, an advisor to Knight, who in late 1963 and early 1964 investigated several financially troubled savings and loan institutions. According to his own testimony, Knight asked Hulman to examine the records of City Savings on file with the Department of Financial Institutions after learning of its financial straits in late 1963. In the course of his investigation, Hulman uncovered evidence strongly suggesting that City Savings had made inflated mortgage loans on overvalued property in the Apple Orchard and Howie-in-the-Hills projects. He also discovered that City Savings had recorded as "income" commissions on refinanced loans that were in fact never collected; that City Savings had listed among its assets $779,000 in promotional expenses which, if accorded proper accounting treatment, would have left the association without sufficient funds to cover even a minor loss; that City Savings had incurred excessive expenses in maintaining its accounts; and that City Savings' contingent reserves were low. These findings, together with Hulman's conclusion that City Savings was "in trouble," all were reported to Knight in January 1964.

They did not stand alone, however, for there were other facts at hand in January 1964 that should have alerted Knight to the need for immediate action, and all the more so after Hulman's dire report. Knight admitted, for example, that he knew in 1963

that City Savings' contingent reserves were less than the statutory minimum of 7½ percent.[6] He also learned in 1963, again by his own admission, that most of City Savings' loans were made to corporations having the same group of individuals as officers and directors—entities that were controlled, as it turned out, by Mensik and his brother-in-law, both of whom were officers of City Savings.[7] In addition, Knight was well aware that City Savings had been closed by the State of Illinois in 1957, that it had been unable to secure insurance from the Federal Savings and Loan Insurance Corporation, and that any losses it suffered would therefore fall directly on the depositors. Finally, Knight knew, too, that Mensik had been convicted of mail fraud in Maryland in November 1963.

And yet, despite all this—the inability to obtain insurance, the evidence of excessive loans on overvalued property, the reports of improper accounting methods and dangerously low reserves, the troubled history of both Mensik and City Savings—despite all this and more, Knight failed to take any corrective action until June 26, 1964.[8] This failure to act decisively in

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[6] As the district court noted, even though Knight knew in 1963 and 1964 that the contingent reserves of City Savings were less than the statutory minimum of 7½ percent, he permitted the association to declare a dividend in December 1963 in clear violation of Section 780(b)(1) of the Illinois Savings and Loan Act.

[7] This, too, was in violation of the Illinois Savings and Loan Act, as the lower court noted. Section 801 prohibits loans by an association "to any corporation of which a majority of the stock is owned or controlled . . . by any one or more of the directors [or] officers . . . of such association."

In this connection, it is also significant that the annual statements of City Savings filed with the of Financial Institutions and the association's books and records revealed that more than eighty percent of its mortgage loans were "secured" by property in the Apple Orchard and Howie-in-the-Hills developments alone in 1963.

[8] The first action of any kind that Knight took came on April 30, 1964—four months after learning of the overvalued loans and other irregularities—when he requested the Peat, Marwick audit.

the face of mounting evidence of statutory violations and financial mismanagement can only be characterized as a willful breach of Knight's official duties as Director of the Department of Financial Institutions. Thus, on the basis of these facts, none of which are in dispute, we must agree with the district court that Knight maliciously breached his statutory duty to supervise the affairs of City Savings, and that his Estate is therefore liable to the depositors for all losses resulting therefrom.

IV. Count II

The district court also held the Estate liable for Knight's role in the adoption of the so-called plan of voluntary liquidation in July 1964. Under this plan, Knight relinquished control of City Savings' assets to three voluntary liquidators—one nominated by Mensik and the other two by the State of Illinois—on September 11, 1964. The voluntary liquidation thus left City Savings with no judicial supervision from June 26, 1964 until September 7, 1968, when Judge Campbell terminated the liquidation and appointed federal receivers.

The lower court concluded that Knight could be found liable for permitting the adoption of the plan under either of two theories: (1) fraud or (2) the breach of ministerial duties. On the first theory, the Estate argues that Count II of the receivers' complaint did not allege Knight's conduct to be fraudulent and thus violated Rule 9(b) of the Federal Rules of Civil Procedure. We need not decide this question, however, for we find ample grounds to affirm summary judgment on Count II in what the lower court termed the "statutory violation theory."

At issue here are the duties imposed on the Director of the Department of Financial Institutions by Sections 921 and 922 of the Illinois Savings and Loan Act, Ill. Rev. Stat. ch. 32, §§ 921-922 (1963). Section 921 provides:

> If the Director, after taking custody of an association . . . finds that any one or more of the reasons for taking custody continues to exist through the period of his custody, then he shall appoint any qualified person, firm or corporation as receiver or co-receiver of such association or trust for the purpose of liquidation.

Section 922 provides:

> After so appointing a receiver, the Director of the Department of Financial Institutions] shall direct the Attorney General to file a complaint in equity in the name of the Director in the circuit or superior court of the county in which such association or trust is located and against the association or trustees or liquidators, as the case may be, for the orderly liquidation and dissolution of the association or trust and for an injunction restraining the officers, directors, trustees, or liquidators, from continuing the operation of the association or trust.

If these duties can be properly characterized as "ministerial," and if Knight did in fact breach them in permitting the adoption of the voluntary liquidation plan, then the Estate is liable for any injuries to the depositors caused by Knight's negligent conduct.[9] *People* ex rel. *Munson v. Bartels*, 138 Ill. 322, 27 N.E. 1091 (1891); *Thiele v. Kennedy*, 18 Ill. App. 3d 465, 309 N.E.2d 394 (3d Dist. 1974).

It is clear to us that the duties prescribed by Sections 921 and 922 are indeed "ministerial" as the Illinois Supreme Court has defined that term:

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[9] As discussed *supra* at (A. 6), Knight's statutory duties were owed to the depositors of City Savings.

> Official duty is ministerial when it is absolute, certain and imperative, involving merely the execution of a set task, and when the law which imposes it prescribes and defines the time, mode, and occasion of its performance with such certainty that nothing remains for judgment or discretion.

People ex rel. *Munson v. Bartels, supra* at 328. Section 921 states that *if* the Director finds that "any one or more of the reasons for taking custody continues to exist through the period of his custody," he "*shall* appoint any qualified person, firm or corporation as receiver." Similarly, Section 922 states that *after* appointing a receiver, the Director "*shall* direct the Attorney General" first to file a complaint in equity against the association to insure an orderly dissolution, and second to seek an injunction restraining the officers and directors of the association from continuing operations. Clearly, then, Sections 921 and 922 call for the execution of set tasks and define the "'time, mode and occasion of [their] performance with such certainty that nothing remains for judgment or discretion." *People* ex rel. *Munson v. Bartels, supra* at 328.

It is equally apparent that Knight breached the ministerial obligations of Sections 921 and 922. By his own admission, none of the conditions that finally compelled him to take custody of City Savings on June 26, 1964 were cured when he relinquished control of the association on September 11, 1964. But in disregard of Sections 921 and 922, Knight failed to (1) appoint a receiver for City Savings, (2) direct the Attorney General to file a complaint against City Savings, or (3) direct the Attorney General to seek an injunction restraining the officers and directors of City Savings from continuing operations. This failure of a public official to perform acts required by statute constitutes an actionable breach of a ministerial duty. See *People* ex rel. *Pope County v. Shelter*, 318 Ill. App. 279, 47 N.E.2d 732 (4th Dist. 1943). Thus, we agree with the district court that the Estate is liable to the depositors of City Savings

for all damages resulting from Knight's acquiescence in the adoption and implementation of the voluntary liquidation plan.

We have examined the Estate's other arguments and find them to be without merit. The judgment of the district court is therefore

Affirmed.

APPENDIX B

United States District Court
Northern District of Illinois
Eastern Division

Alexander Tcherepnin, et al.,
Plaintiffs,
vs.
Robert Franz, et al.,
Defendants.
No. 64 C 1285

MEMORANDUM AND ORDER

(Dated April 14, 1975)

This matter comes before the court on the motion of cross-plaintiff City Savings Association (City Savings), by its receiver Samuel Berke, and pursuant to Rule 56 of the Federal Rules of Civil Procedure for entry of summary judgment on Counts I, II and III of its Amended First Cross-Complaint against cross-defendant First National Bank & Trust Company of Alton, Illinois, executor of the estate of Joseph E. Knight (Estate of Knight). In addition, the Estate of Knight has moved to dismiss Counts I, II and III of the Amended First Cross-Complaint. Cross-defendant Justin Hulman has joined in the motion to dismiss and has adopted the Estate of Knight's memorandum in support thereof. For the reasons set forth below, the motions to dismiss shall be denied and the receiver's motion for summary judgment shall be granted as to Counts I and II and denied as to Count III.

This complex and protracted litigation involves the events surrounding the collapse of City Savings Association, a savings and loan association chartered by the State of Illinois and pres-

ently under the control of federal receivers. The history of City Savings and its mentor, C. Oran Mensik, is a chronicle of political intrigue and corruption perhaps unmatched in Illinois history. It is replete with examples of official misconduct and chicanery and permeated with a blatant disregard by both state and City Savings officials for the rights of the unfortunate depositors. The result of these defalcations was a massive fraud which milked the depositors of nearly $23,000,000.

To fully comprehend the allegations made in the Amended First Cross-Complaint, the history of City Savings and of this litigation must first be reviewed in some detail.

Events prior to the Commencement of This Litigation

City Savings Association was founded in 1908 in Chicago, Illinois. It issued to its depositors withdrawable capital shares, as authorized by the Illinois Savings and Loan Act, Ill.Rev. Stat. 1963, ch. 32, §§ 701-944. City Savings was located in and serviced an area known as the Chicago-Ashland business district, a focal point for various Chicago ethnic groups. *The Failure of the City Savings Association* a report to the Illinois General Assembly, Illinois Legislative Investigating Commission, January, 1972 (hereinafter referred to as Legislative Report), p. 1.

In 1942, C. Oran Mensik, the principal manipulator of this fraud, first became associated with City Savings. Mensik's emergence as president and director of City Savings, six months later, marked the beginning of an astounding period of economic growth. When Mensik joined City Savings there were 348 shareholders and $147,000 in assets. By 1952, the reported assets of City Savings had reached $12,000,000 and in the next five years this figure climbed to over $35,000,000. Mensik remained in control of City Savings until at least 1964. Legislative Report, p. 1.

On July 18, 1956, the Auditor of Public Accounts for the State of Illinois, the public official then charged with the supervision of state-chartered savings and loan associations, ordered state examiners to conduct an examination of the books and records of City Savings. Subsequent examinations were made in October 1956 and February 1957. The last examination report was sent to the management of City Savings on April 16, 1957, and was accompanied by a letter from the Auditor outlining the State's criticisms and recommendations. On April 23, these examinations were released to the press. The resulting publicity caused a run on City Savings. On April 25, 1957, the Auditor declared an "emergency," took custody of City Savings and closed its doors to the public. Ill.Rev.Stat. 1955, ch. 32, § 848; Legislative Report, pp. 3-8.

The examination findings upon which the Auditor relied revealed: that the capital of City Savings was severely impaired; that certain favored companies staffed and operated by Mensik's associates and relatives had received a disproportionate amount of mortgage loans; that properties securing mortgage loans were greatly overappraised; and that Mensik was involved in two other guarantee associations which were both in financial straits. Legislative Report, p. 7.

In response, Mensik filed suit in the Circuit Court of Cook County charging that the Auditor and five of his associates were engaged in a conspiracy to "steal" Mensik's associations from him. The matter was referred to Nathan M. Cohen as Master in Chancery. After an extensive hearing, the Master concluded that the responsibility for the emergency was chargeable to the Auditor because of his untimely release of the confidential report and that the state seizure was therefore illegal. On December 6, 1957, Judge Cornelius Harrington adopted the Master's findings and ordered that control of City Savings be returned to Mensik. This decision was ultimately affirmed by the Supreme Court of Illinois in 1960. *Mensik v. Smith*, 18 Ill.2d 572, 166 N.E.2d 265 (1960).

Judge Harrington, however, also found that some of the criticisms registered by the Auditor were valid and retained supervisory jurisdiction over City Savings to oversee the implementation of certain suggested remedial measures. One of these suggestions was the institution of a system of limited and restricted withdrawals pursuant to Section 773(b) of the Illinois Savings and Loan Act, Ill.Rev.Stat. 1963, ch. 32, § 773(b). Legislative Report, pp. 8-11.

On December 19, 1957, City Savings was reopened to the public. On February 3, 1959, Judge Harrington determined that the conditions which the court directed to be remedied had been in fact corrected and terminated all judicial supervision of City Savings. Legislative Report, p. 11.

The rapid growth experienced by City Savings prior to its 1957 closing declined sharply due both to the damaging publicity it had received and to its decision to operate under the provisions of Section 773(b). Legislative Report, p. 14.

On July 9, 1959, the Illinois General Assembly enacted Section 773(h) of the Illinois Savings and Loan Act. Ill.Rev.Stat. 1959, ch. 32, § 773(h). It provided:

> (h) An association while operating under this Section may accept additional withdrawable capital from its present shareholders as well as accept new withdrawable capital accounts and such withdrawable accounts shall not be subject to the provisions of subsection (b) of this Section but shall be subject to withdrawal at will so long as the association is operating under the provisions of subsection (b) of this Section.[1]

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[1] The Legislative Report concluded that there was "no satisfactory explanation for its [section 773(h)] resurrection at precisely the time it became vital to Mensik's operations, for there was no other savings and loan in the State of Illinois which stood to benefit from its re-enactment." Legislative Report, p. 13.

Mensik seized the unique advantages offered by this new law and embarked on an extensive advertising campaign, offering expensive prizes such as television sets and radios to new depositors. He also blazoned the maxim "Under State Government Supervision" on his letterheads and circulars. Legislative Report, p. 14.

In January 1964, the State Department of Financial Institutions, to whom supervisory authority over state-chartered savings and loan associations had been transferred, began an examination of the affairs of City Savings. The examination included an audit by Peat, Marwick, Mitchell & Co., independent public accountants, whose report dated June 15, 1964, showed a capital impairment of approximately $14,000,000. *Tcherepnin v. Franz*, 316 F. Supp. 714 (N.D.Ill. 1970). On June 26, 1964, the State of Illinois took custody of City Savings and on June 30, 1964, City Savings was closed to the public. Legislative Report, pp. 14-17.

On July 28, 1964, a meeting of the depositors of City Savings was held at which a plan of voluntary liquidation, agreed upon between Mensik and the State of Illinois, was put forward and approved by the depositors. Pursuant to the plan, three voluntary liquidators were appointed, one nominated by Mensik and the other two by the State of Illinois. Legislative Report, pp. 17-18.

The Federal Litigation

On July 24, 1964, four days prior to the depositors' meeting called to solicit approval of the plan of voluntary liquidation, the plaintiffs' complaint was filed by Alexander Tcherepnin and certain other holders of withdrawable capital shares of City Savings. Their complaint named Joseph E. Knight, then Director of the Department of Financial Institutions of the State

of Illinois; Justin Hulman, then Supervisor of the Savings and Loan Division of the Department; certain officers and directors of City Savings; and Louis Kwasman, Harry Hartman and Dennis Kirby, the voluntary liquidators of City Savings, as parties defendant. Defendants Hartman and Kirby were savings and loan examiners and employees of the Department of Financial Institutions; Kwasman was a business associate and nominee of Mensik.

Plaintiffs alleged in their complaint that their withdrawable capital shares in City Savings were securities within the purview of the Securities Exchange Act of 1934, 15 U.S.C. § 78(a), *et seq.*, and were purchased in reliance upon false and misleading solicitations made in violation of that act. The plaintiffs sought rescission of their purchases and recovery of their investment.

No wrongdoing was alleged by, and no relief was sought against, the named state officials or the State of Iilinois. Nonetheless, on November 20, 1964, the Attorney General of the State of Illinois moved to strike and dismiss the complaint.

On January 17, 1966, Judge Campbell, before whom the matter was then pending,[2] denied all motions to dismiss plaintiffs' complaint and held that plaintiffs owned "securities" as defined by federal law, and certified his ruling for an interlocutory appeal. Tcherepnin v. Franz, 277 F. Supp. 472 (N.D.Ill. 1966).

On January 20, 1967, the United States Court of Appeals for the Seventh Circuit reversed Judge Campbell's order and, with one Judge dissenting, held that the plaintiffs were not in fact holders of "securities." *Tcherepnin v. Knight*, 371 F. 2d 374 (7th Cir. 1967).

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[2] This case was originally assigned to the late Judge Michael Igoe. The matter was reassigned to then Chief Judge William J. Campbell in 1965. After extensive proceedings before Judge Campbell and his taking senior status on August 29, 1972, the Executive Committee of this court reassigned this case to myself.

On December 18, 1967, the United States Supreme Court reversed the order of the court of appeals and held that plaintiffs' withdrawable capital shares were "securities" within the meaning of the Securities Exchange Act of 1934, 15 U.S.C. § 78 (a), *et seq. Tcherepnin v. Knight*, 389 U.S. 332 (1967). The matter was remanded to this court for further proceedings.

On February 9, 1966, the plaintiffs first moved for the appointment of a receiver to replace the state-supervised voluntary liquidators. Judge Campbell denied this motion but indicated that he would reconsider his decision after appellate review of his order sustaining plaintiffs' complaint. *Tcherepnin v. Franz*, 277 F. Supp. 472 (N.D.Ill. 1966).

On May 29, 1968, upon remand from the Supreme Court, plaintiffs renewed their motion for the appointment of a receiver. From August 19, 1968, to August 23, 1968, a full hearing on the motion was held.

On September 7, 1968, Judge Campbell entered an order appointing Leonard B. Ettelson and William J. Friedman receivers of City Savings.[3] In this order Judge Campbell found that the state-supervised plan of voluntary liquidation was:

> . . . tainted with fraud. . . . No reasonable person could have concluded, and I specifically find that Justin Hulman did not believe on June 15, 1964, that the liquidation of City Savings Association . . . could ever result in anything but an enormous loss to the depositors. Nevertheless, the State, while in custody of City Savings Association, allowed C. Oran Mensik . . . to call a meeting of the shareholders [fraudulently] soliciting proxies. . . . Commissioner

[3] Leonard B. Ettelson and William J. Friedman ably served as receivers of City Savings from September 7, 1968, until their resignation on March 27, 1973. On that date, Samuel Berke was appointed receiver of City Savings by order of this court and has ably acted in that capacity to this date.

> Hulman was aware of these misrepresentations before, during and after the fact and at no time did he prevent or correct these lies although he had the power and duty to do so. . . .
>
> I find and conclude that the representations made to the shareholders of City Savings Association were false, misleading and deceptive. . . . I therefore hold the voluntary liquidation is void because it was tainted with fraud from its inception.

Order of September 7, 1968.

This order was subsequently appealed and affirmed. *Tcherepnin v. Kirby*, 416 F.2d 594 (7th Cir. 1968).

On October 10, 1968, Judge Campbell entered an order tentatively delineating two classes of depositors—the plaintiffs consisting of post-July 9, 1959 depositors and the intervening defendants consisting of pre-July 9, 1959 depositors. On March 10, 1970, Judge Campbell held that the plaintiffs were entitled to a preference in the distribution of the assets of City Savings. This order was affirmed on appeal. *Tcherepnin v. Franz*, 461 F.2d 544 (7th Cir. 1972).

Thereafter, in November 1974, the plaintiffs, intervening defendants and the receiver entered into a settlement agreement whereby the plaintiffs were dismissed from the case and any further recovery of assets would run to the benefit of the intervening defendants. The plaintiffs had recovered approximately 100 per cent of their investment in City Savings.

On August 6, 1970, Judge Campbell entered an order imposing a constructive trust on certain property located in the Chicago-land area for the benefit of City Savings and its depositors. *Tcherepnin v. Franz*, 316 F. Supp. 714 (1970). That order was also affirmed on appeal. *Tcherepnin v. Franz*, 485 F.2d 1251 (7th Cir. 1973).

On January 15, 1969, the receivers filed their First Cross-Complaint, naming Joseph E. Knight, Justin Hulman and Dennis Kirby as cross-defendants. On September 23, 1969, the receivers amended the cross-complaint to name Chris Stolfa, former Supervisor of Savings and Loan Associations of the State of Illinois, Louis Kwasman, Harry Hartman, William DeWoskin, Richard Ray and Steven J. Kadlicek, voluntary liquidators of City Savings, as additional cross-defendants. Cross-defendants Hartman and Kadlicek were also employees of the Department of Financial Institutions for the State of Illinois.

The cross-complaint was again amended to add the State of Illinois and Fidelity and Deposit Company of Maryland as additional cross-defendants. Fidelity and Deposit Company was the surety for the individual cross-defendants.

The gravamen of the Amended First Cross-Complaint is that the named officers and employees of the State of Illinois and the other voluntary liquidators breached their statutory duties to City Savings, thereby rendering themselves, the State of Illinois and their surety liable for damages to the depositors of City Savings.

On April 6,1972, the State of Illinois moved to dismiss the Amended First Cross-Complaint and for summary judgment. The receivers filed a cross-motion for summary judgment. In a memorandum entered March 12, 1973, this court, with myself presiding, denied the State's motions and granted the receiver's cross-motion for summary judgment against the State of Illinois. In that memorandum, it was specifically found that, "The willful failure of the State through its officials, agents and employees to adequately supervise City Savings . . . was . . . willful and wanton negligence" and that the State was liable to the depositors of City Savings for the damages they incurred as a result of the collapse of that institution. Memorandum, Findings of Fact, Conclusions of Law and Decree entered March 12, 1973, p. 28.

Subsequently, the State and the receivers entered into settlement negotiations. On September 10, 1973, the Governor signed into law a bill passed by the 78th General Assembly appropriating $12,467,500 for the reimbursement of the depositors of City Savings.

On October 9, 1973, this court entered an agreed order approving a settlement between City Savings and the State of Illinois and ordering that the State be dismissed with prejudice as a cross-defendant.

On June 25, 1973, the Estate of Knight filed a motion to dismiss Counts I, II and III of the Amended First Cross-Complaint.

On November 5, 1973, the receiver filed a motion for summary judgment against cross-defendants Justin Hulman, Chris Stolfa, Louis Kwasman, Harry Hartman, Dennis Kirby, William DeWoskin, Richard Ray, Steven J. Kadlicek and the Estate of Knight, and on February 25, 1974, the receiver filed a motion for summary judgment against cross-defendant Fidelity and Deposit Company of Maryland. Although these motions were initially consolidated for briefing, pursuant to the request of the receiver, the motion for summary judgment against the Estate of Knight was placed on an accelerated briefing schedule and is the subject of this memorandum. The Estate of Knight is a named cross-defendant in the first three counts of the First Amended Cross-Complaint. These counts deal with events in chronological order and will be discussed individually.

Count I

Count I of the Amended First Cross-Complaint deals with events transpiring between 1959 and June 1964, when City Savings was closed by the State for the second time. Named as

cross-defendants are the Estate of Knight, Chris J. Stolfa and Justin Hulman. Donald Swope, who was originally named as a cross-defendant, was dismissed pursuant to this court's order of October 9, 1973.

Joseph E. Knight was the Director of the Department of Financial Institutions for the State of Illinois from January 16, 1962, to April 1968. Prior to that appointment, he served as Secretary to the Illinois Commerce Commission under former Governor Henry Horner, Supervisor of Loan Companies under former Governor Adlai Stevenson and Assistant Director of the Department of Financial Institutions under former Governor Otto Kerner. Knight, pp. 4-5, 11; Legislative Report, p. 54.[4]

Chris J. Stolfa was Supervisor of Savings and Loan Associations for the Department of Financial Institutions from 1959 (1960?) to November 1963. Stolfa had been a state employee since 1942. The bulk of his experience was in the area of state supervision of financial institutions. Stolfa, pp. 3-11; Legislative Report, p. 57.

Justin Hulman was first employed by the State of Illinois on January 15, 1964, as a technical advisor to Joseph Knight. Prior to that, in November and December 1963, Hulman acted as an unofficial advisor to Knight in connection with the examination of various savings and loan associations which appeared to be in financial straits. On June 5, 1964, Hulman was appointed by Knight as Supervisor of Savings and Loan Associations for the Department of Financial Institutions. On August 1, 1965, his official designation was changed by statute to Commissioner of Savings and Loan Associations, a position he held until his resignation on October 1, 1969. Hulman, pp. 2-7; Legislative Report, pp. 55-56.

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[4] References to deposition testimony are indicated by the name of the witness and the page at which the statement appears.

Donald Swope was acting Supervisor of Savings and Loan Associations from November 1963 until June 6, 1964, when he was replaced by Hulman. Stolfa, p. 5; Knight, p. 9.

The Illinois Savings and Loan Act, Ill.Rev.Stat. 1963, ch. 32, §§ 701-944, in effect for the period 1959-63, imposed a comprehensive duty on the Director of the Department of Financial Institutions and the officers and employees of that department to supervise the affairs of all savings and loan associations within the state and to ensure that these businesses were operated "only by associations organized and conducted in accordance with the authority provided in this Act." Ill.Rev.Stat. 1963, ch. 32, § 702(b).

Section 842(a) of the Illinois Savings and Loan Act required the Director of the Department of Financial Institutions to at least once a year conduct an examination of every savings and loan association in the state:

> (a) The Director, at least once in each year, without previous notice, shall cause an examination to be made of the affairs of every association. Such examination shall be made by competent examiners appointed for that purpose, who are not officers or agents of, or in any manner interested in, any association which they examine, except that they may be holders of withdrawable capital.

Section 842(b) of the Act granted to the Director or his examiners access to the books and records of every savings and loan association and empowered them to question the management and employees of those associations regarding the conduct of its affairs:

> (b) The officers, agents, or directors of any such association shall cause the books of the association to be opened for inspection by the Director or his examiners and otherwise assist in such examination when requested;

and for the purpose of examination, the examiner in charge thereof shall have power to administer oaths and to examine under oath any officers, employees, agents, or directors of such association relative to the business of the association.

Section 842(c) of the Act required the Director of the Department of Financial Institutions to report his findings to the board of directors of the examined institution and to require that any necessary corrective action be taken:

> (c) The Director shall make a report of each examination to the board of directors of the association examined, and if the affairs of the association are not being conducted in accordance with this Act, he may require the directors, officers, or employees to take any necessary corrective action. In the interests of the members of the association, the Director may prepare a statement of the condition of the association, and may mail the same to the members or may require a single publication thereof.

Section 843 empowered the Director of the Department of Financial Institutions to order, without prior notice, an audit by a certified public accountant of the books of any association. Section 844 required every association to file with the Department of Financial Institutions within 60 days following the close of the fiscal year a statement showing its financial condition at the close of the fiscal year In addition, Section 844 empowered the Director of the Department of Financial Institutions to require any other reports he deemed necessary.

Within this statutory framework, the Director of the Department of Financial Institutions appointed the Supervisor of Savings and Loan Associations. The Supervisor was directly answerable to the Director and was charged with the responsibility of overseeing the affairs of savings and loan associations within the state and reporting any statutory violation or other problems to the Director.

Count I of the receiver's Amended First Cross-Complaint alleges, and these facts are undisputed, that during the period from 1959 through June of 1964 the affairs of City Savings were manifestly not being conducted in accordance with the provisions of the Illinois Savings and Loan Act. During this period, City Savings loaned over $21,000,000 to entities controlled by Mensik or his nominees. Purportedly securing these loans were two proposed real estate developments, the so-called "Apple Orchard" and "Howie in the Hills" projects. These loans were based on grossly inflated and fraudulent appraisals. On June 30, 1964, the date City Savings was closed, the outstanding net unpaid balance of the Apple Orchard loans was $14,827,415.20 and the outstanding net unpaid balance of the Howie in the Hills loans was $5,675,047.14. *Tcherepnin v. Franz*, 316 F. Supp. 714, 718 (N.D.Ill. 1970). An appraisal made shortly before the filing of the Amended First Cross-Complaint in 1969 indicated that the true value of the Apple Orchard and Howie in the Hills subdivision properties was $6,391,751.31. These loans were the greatest single factor in the demise of City Savings.

In addition, many other acts of misconduct occurred at City Savings including the use of unacceptable accounting and management practices, self-dealing and questionable advertising practices.[5] It is undisputed that these illegal acts occurred and that they rendered City Savings in a grossly unsound financial condition with a capital impairment of over $14,000,000. *Tcherepnin v. Franz*, 316 F. Supp. 714 (N.D. Ill. 1970); Special Report of Peat, Marwick, Mitchell & Co. regarding City Savings Association dated June 15, 1964; Legislative Report, pp. 36-38, 67-69.

The gravamen of Count I is that the affairs of City Savings were being so grossly mismanaged during the years 1959-64 that no reasonable person could have made even the most cur-

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[5] These acts of misconduct were brought to the attention of State of Illinois officials at least six months prior to closing of City Savings and are discussed at length *infra at* (A. 35-36).

sory examination of City Savings and reasonably have believed it to be sound or that the management should not be removed. The receiver further alleges that during the period from 1959-64 there were either no meaningful examinations made by the Director of the Department of Financial Institutions or that, in the alternative, the examinations in fact were made and the results either ignored or concealed. In either event, the reciever charges that cross-defendants Knight, Stolfa and Hulman breached their statutory duty owing to City Savings, its members, and creditors and are liable for damages arising therefrom.

The Estate of Knight asserts that based upon the information available to Knight, he acted in a manner consistent with his statutory duties as Director of the Department of Financial Institutions.

Illinois decisions have consistently held that public officials vested with discretion and empowered to exercise their judgment are immune from liability to third persons provided that the acts complained of are discretionary in nature, done within the scope of the official's authority and not resulting from malicious or corrupt motives. *People ex rel. Schreiner v. Courtney*, 380 Ill. 171, 43 N.E.2d 982 (1942); *McCormick v. Burt*, 95 Ill. 263 (1880); *Gilbert v. Bone*, 64 Ill. 518 (1872); *Anderberg v. Newman*, 5 Ill. App.3d 736, 283 N.E.2d 904 (1st Dist. 1972); *Paoli v. Mason*, 325 Ill. App. 197, 59 N.E.2d 499 (1st Dist. 1945). However, where the duty imposed on a public official is purely ministerial, that official will be held liable to third persons for the negligent performance of that duty. *People ex rel. Munson v. Bartels*, 138 Ill. 322, 27 N.E. 1091 (1891); *Thiele v. Kennedy*, 18 Ill. App.3d 465, 309 N.E.2d 394 (3d Dist. 1974); *Anderberg v. Newman, supra.*

The distinction between ministerial and discretionary duties was discussed in an early Illinois Supreme Court opinion, *People ex rel. Munson v. Bartels, supra* at 328, where the court said:

> Official action is judicial where it is the result of judgment or discretion. When the officer has the authority to hear and determine the rights of person or property, or the propriety of doing an act, he is vested with judicial power. An officer will be regarded as being clothed with judicial or quasi-judicial functions, when the powers confided to him are so far discretionary that he can exercise or withhold them according to his own judgment as to what is necessary and proper. . . .
>
> . . . Official duty is ministerial when it is absolute, certain and imperative, involving merely the execution of a set task, and when the law which imposes it, prescribes and defines the time, mode and occasion of its performance with such certainty that nothing remains for judgment or discretion. Official action is ministerial when it is the result of performing a certain and specific duty arising from fixed and designated facts.

In practice, however, Illinois courts have tended to confine discretionary immunity to fairly high level public officials and to important decisions by these officials involving determinations of law or fact or the establishment of significant public policy. *See Kelly v. Ogilvie*, 64 Ill. App.2d 144, 212 N.E.2d 279 (1st Dist. 1965), *aff'd*, 35 Ill. 2d 297, 220 N.E.2d 174 (1966); *Bush v. Babb*, 23 Ill.App.2d 285, 162 N.E.2d 594 (1st Dist. 1959); *Paoli v. Mason, supra;* Baum, *Tort Liability of Local Governments and their Employees: An Introduction to the Illinois Immunity Act*, 1966 U.Ill. L.F. 981, 997 (1966). A single public officer may have both ministerial and discretionary duties.

Public officials are not liable to third persons for the misconduct or negligence of their subordinates provided that the official does not direct the acts complained of or personally co-

operate in the negligence from which the injury results. *Kelly v. Ogilvie*, 35 Ill.2d 297, 220 N.E.2d 174 (1966); 63 Am.Jur. 2d Public Officers and Employees § 295 (1972).

Finally, the failure to perform a public duty can constitute an individual wrong only when it is shown that the duty was owed not only to the State of Illinois but also to the private individuals seeking redress. *People of the State of Illinois v. Maryland Casualty Co.*, 132 F.2d 850 (7th Cir. 1942); *State v. American Surety Co.*, 26 Idaho 652, 145 P. 1097 (1914).

Although the standards of liability enumerated above have not been applied to state banking officials by Illinois courts, the courts of other states have applied analogous principles to their state banking officials. *Deatsch v. Fairfield*, 27 Ariz. 387, 233 P. 887 (1925); *Dunbar v. Faut*, 170 S.C. 414, 170 S.E. 460 (1913); *State v. American Surety Co.*, 26 Idaho 652, 145 P. 1097 (1914); Keefe, *Personal Tort Liability of Administrative Officials*, 12 Fordham L.Rev. 130, 141-43 (1943).

The Estate of Knight contends that the allegations contained in Count I are insufficient to support a cause of action because: 1) there is no allegation of direct participation or supervision by Knight in the wrongful acts; and 2) there are no specific allegations of malice or corruption on the part of Knight.

The short answer to the first contention is that the cross-complaint while not specifically charging Knight with wrongful acts, does allege that the Director of the Department of Financial Institutions committed these acts and that Knight was the Director of the Department of Financial Institutions during this period.

In considering the second contention raised by the Estate of Knight, the court first notes that the cross-complaint need not specifically characterize Knight's conduct as being "malicious or

corrupt" provided that the acts complained of necessarily involve a malicious disregard of his obligations to the depositors of City Savings. *State v. Dixon*, 131 Kan. 650, 103 P. 130 (1909). Thus, the crucial issue is whether Knight's alleged failure to conduct the required examinations of City Savings or, after having conducted such an examination, his alleged concealment or ignoring of the results constitutes a malicious breach of his statutory duty to supervise the affairs of City Savings.

The adjective "malicious" connotes something more than mere negligence. It has been variously defined as: the intentional commission of a tortious act; the willful and reckless disregard of another's rights; and the wanton and deliberate commission of a wrongful act.[6]

Knight had a statutory duty to supervise the affairs of City Savings and to *ensure* that it was operating in accordance with the provisions of the Illinois Savings and Loan Act. This obligation ran directly to the depositors of City Savings. *State v. American Surety Co., supra.* The conclusion is inescapable that if, in fact, Knight intentionally ignored or concealed examinations indicating that the investments of the City Savings depositors were being jeopardized by the failure of City Savings to conduct its business in accordance with the provisions of the Illinois Savings and Loan Act that, under any of the accepted definitions, he was "maliciously" breaching his statutory duty owed to those depositors. It is therefore the opinion of the court that the motion to dismiss Count I of the Amended First Cross-Complaint must be denied.

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[6] The cases supporting these definitions are legion. *See, e.g., Fromm v. Seyller*, 245 Ill.App. 392 (2d Dist. 1927); *Kaplan v. Williams*, 245 Ill.App. 542 (1st Dist. 1927); *Smith v. Moran*, 43 Ill. App.2d 373, 193 N.E.2d 466 (2d Dist. 1967); *State v. Dixon*, 131 Kan. 650, 103 P. 130 (1909); *Baer v. Rosenblatt*, 106 N.H. 26, 203 A.2d 773 (1964); *Maddix v. Gammon*, 293 Ky. 540, 169 S.W.2d 594 (1943); *McElwain v. Georgia-Pacific Corp.*, 245 Or. 247, 421 P. 2d 957 (1966); *Loucks v. Albuquerque National Bank*, 76 N.M. 735, 418 P.2d 191 (1966).

Having rejected the motion to dismiss Count I, the court now turns to the receiver's motion for summary judgment. The first issue to be resolved is the effect this court's order of March 12, 1973, may have had upon the imposition of the burden of proof on the motion for summary judgment. Rule 56 of the Federal Rules of Civil Procedure clearly imposed on the party moving for summary judgment the burden of demonstrating that there is no genuine issue of material fact and that the moving party is entitled to judgment as a matter of law. *Melancon v. Insurance Company of North America*, 482 F.2d 1057 (5th Cir. 1973); *Ashwell & Company v. Transamerica Insurance Company*, 407 F.2d 762 (7th Cir. 1969); 6 Moore's *Federal Practice* ¶ 56.15 [3] and cases cited therein.

This court's order of March 12, 1973 found that "the Supervisors of Savings and Loan Associations and the Director of Financial Institutions were to say the least grossly negligent in their supervision of what has become the notorious City Savings Association." Memorandum, Findings of Fact, Conclusions of Law and Decree of March 12, 1973, p. 20. On October 9, 1973, as part of the receiver's settlements with the State of Illinois, that memorandum was "withdrawn and vacated insofar as the rights, liabilities and interests of the State of Illinois and its present officers and officials are concerned." Order of October 9, 1973, p. 4. No mention was made as to the effect the findings made in the March 12, 1973 order would have on the receiver's claims against the cross-defendants other than the State of Illinois. It is the receiver's contention that the findings of fact and conclusions of law contained in this court's March 12, 1973 order were left intact insofar as they relate to the cross-defendants other than the State of Illinois and thus the cross-defendants have the burden of disproving these findings.

The court is of the opinion that the burden of proof in the instant motion for summary judgment lies with the receiver.

Although findings of fact were made which reflect upon the conduct of the remaining cross-defendants, these parties were not given an opportunity at that time to respond to the receiver's allegations. In fairness to the remaining cross-defendants, the court cannot impose the additional burden of overturning those findings.

Practically speaking, the remaining cross-defendants do have the burden of coming forward with new evidence or additional arguments which would persuade the court that it was in error when it issued its March 12, 1973 order. In any event, the court has reviewed anew the record in its entirety and has applied to the evidence the standards set forth in the cases and treatise cited above.

Applying these standards to the massive record in this case, the court is of the opinion that Joseph E. Knight willfully and maliciously disregarded his duty to supervise City Savings during the period he was Director of the Department of Financial Institutions and that his estate is liable to the depositors of City Savings for the damages arising from these acts. The undisputed testimony and admissions of Knight and other state officials clearly support this conclusion.

Knight testified that he first learned that City Savings was in financial straits in the latter part of 1963 when he was advised by either Justin Hulman or Donald Swope that City Savings had made excessive loans on both the Apple Orchard and Howie in the Hills developments. Knight, pp. 21-25. In fact, as was described above, City Savings made loans exceeding $21,000,000 to develop these real estate projects. The actual estimated value of these properties at the time City Savings was closed in June of 1964 was only $2,000,000. *Tcherepnin v. Franz*, 316 F. Supp. 714, 718 (N.D.Ill. 1970). Knight testified that the only corrective measure taken by him at this time was to order that appraisals be made on the properties. Wigo Juergensen, testi-

fying on behalf of Knight, stated that the appraisals were not ordered until after the Peat, Marwick audit was requested on April 30, 1964. These appraisals were not prepared until early June 1964. Juergensen, pp. 6-9. Thus, no action was taken by Knight until April 30, 1964—four months after he first learned of the overvalued loans.[7]

In January 1964, Knight asked Justin Hulman to examine the records of City Savings that were in the possession of the Department of Financial Institutions. Knight, pp. 40-41. Since November 1963, Hulman had been conducting a series of examinations of financially troubled savings and loan associations for Knight. Hulman, pp. 11-29. During the period November-December 1963, Hulman was acting of an unofficial advisor to Knight.

Prior to investigating City Savings, Hulman had reviewed the records of both Beverly and Tinley Park Savings and Loan Associations. Hulman, p. 15. In these initial studies, Hulman discerned a pattern common to both institutions. He found evidence of excessive loans on overvalued properties, loans to officers, gross mismanagement and some instances of outright fraud. Hulman, pp. 15-17; Knight, pp. 56-64. These findings were reported to Knight in late November 1963. Hulman, p. 17.

Hulman then commenced an examination of the records of Marshall Savings and Loan Association. At Marshall he again found that excessive mortgage loans were being made on over-

[7] Both Knight and Hulman have testified that the appraisals of the Howie in the Hills and Apple Orchard projects were ordered in January 1964 and received in March. Knight, pp. 82-84; Hulman, p. 73. If this version is accurate, Knight must have known of City Savings' severe capital impairment at least four months prior to its closing. Thus, under either version, Knight's culpability is clear. The court, however, for the purposes of the motion for summary judgment must accept Juergensen's statement as accurate.

valued properties. Hulman, pp. 22-23. He also uncovered instances of mismanagement and faulty credit reporting. Hulman, pp. 23-24.

On January 15, 1964, Hulman became a salaried technical advisor to Knight. His continuing investigation of the savings and loan industry disclosed that the records of several other institutions showed irregularities similar to those found at Tinley Park and Beverly. Among the institutions Hulman examined were Success Savings and Loan Association, Service Savings and Loan Association, Apollo Savings and Loan Association and Old Reliable Savings and Loan Association. Hulman, pp. 28-29. During the course of these examination, Hulman noticed that the names of Angelo LoMonaco and Frank Sorrentino repeatedly appeared as appraisors for Tinley Park, Beverly and Marshall. Hulman, p. 23. LoMonaco and Sorrentino also acted as appraisors for many properties securing mortgage loans issued by City Savings. Hulman, p. 69.

With this background, Hulman commenced his examination of the records of City Savings in January 1964. Hulman, p. 40. In conducting his examination, Hulman relied solely upon the records on file with the Department of Financial Institutions.[8]

[8] On file with the Department of Financial Institutions were the audit reports of Stanley Mize, a certified public accountant. During the years 1960 through 1963, Miez filed a series of increasingly critical audit reports in which the following deficiencies were pointed out:

(a) Lack of control over cash transactions;
(b) Distributions to shareholders in excess of net income;
(c) Sharply increasing expenses for maintaining a relatively stable amount of deposits;
(d) Excess payouts to holders of withdrawable capital shares under Section 773 of the Illinois Savings and Loan Act, Ill.Rev.Stat. 1963, ch. 32, § 773;
(e) The concentration of 69% of all mortgage loans among fifteen borrowers;
(f) The improper deferment of excessive advertising costs to to years in which said costs would produce vitrtually no benefits; and
(g) The transfer of funds from contingent reserves in order to dividends to the holders of withdrawable capital shares.

Hulman, p. 40. Later that month he reported his findings to Knight and Swope. Hulman, p. 50.

Hulman advised Knight that City Savings was "in trouble." Hulman, p. 50. He noted that $779,000 listed on the books of City Savings as an asset represented monies used to purchase premiums which had already been given away to entice new depositors. If this asset were written off, as it properly should have been, the reserves of the association would have been insufficient to cover even a minor loss. Hulman, p. 50; Knight, p. 72.

Another matter of concern which was discussed at the meeting was City Savings' practice of refinancing loans. In general, City Savings financed subdivision developments in three phases. In phase one, mortgage money was loaned for the purchase of raw farm land. In phase two, the mortgage loans on the same property were increased for the purpose of subdividing the land and constructing sewers, streets and other improvements. The outstanding balance of the first loan was repaid from the proceeds of the second mortgage loan. In phase three, the mortgage loan was again increased on the same property for the purpose of constructing buildings. The unpaid balance of the second loan was repaid from the proceeds of the third loan. *Tcherepnin v. Franz*, 316 F.Supp. 714, 718 (N.D.Ill. 1970). Every time City Savings refinanced a loan it charged a 4 percent loan commission. Thus, there was income accruing on the books of City Savings without the receipt of any actual cash. Hulman, pp. 52-53.

Another problem area pointed out to Knight was that while the amount of money deposited in the accounts of City Savings remained static for several years, the costs of maintaining these accounts continued to rise and were excessive. Hulman, p. 55. In addition, Hulman's examination revealed the now familiar pattern of excessive loans on overvalued properties. Again the names of LoMonaco and Sorrentino frequently appeared as ap-

praisers for City Savings. Hulman, p. 69; Knight, p. 69. Finally, Hulman advised Knight that the contingent reserve position of City Savings was dangerously low. Hulman, pp. 55, 62-65; Knight, p. 72.

Knight's treatment of City Savings' contingent reserve situation is typical of his utter failure to exercise any degree of supervision over the affairs of City Savings . Section 779(a) of the Illinois Savings and Loan Act, Ill.Rev. Stat. 1963, ch. 32, § 779(a), provided:

> (a) Each association shall have a contingent reserve to which the board of directors shall allocate such portion of the association's profits as the board may determine; except that whenever the total amount of such reserve together with special reserves for losses and the insurance reserve of an insured association is less than 7½ % of the aggregate withdrawal value of the association's withdrawable capital accounts, the allocation to such contingent, special reserve or the insurance reserve of an insured association upon each apportionment of profits shall total not less than 10% of the profits being appropriated, or such lesser portion as will increase the aggregate of such reserves to the required total amount. In lieu of the requirements specifically set forth in the preceding sentence, an *insured* association may make such allocations to the reserves as may from time to time be required by the insurance corporation [Federal Savings and Loan Insurance Corporation]. [Emphasis added.]

Section 780(b)(1) of that Act provided:

> (b) However, the declaration of dividends on capital shall be subject to the following restrictions:
>
> (1) No dividends shall be declared when the total amount of the contingent reserve is less than that required by the section of this Act concerning Reserves [Section 779(a)], unless the allocation provided by said section has been made.

Knight has admitted that he knew in 1963 and 1964 that the contingent reserves of City Savings were less than the statutory minimum of 7½ percent. Knight, p. 71. Yet, he permitted City Savings to declare a dividend in December 1963 in clear violation of Section 780(b)(1). Hulman explained that City Savings had been permitted to operate under the lower standards established for associations insured by the Federal Savings and Loan Insurance Corporation. Hulman, p. 65. City Savings was not and has never been insured by the federal government. As a result, any losses incurred by City Savings would fall directly on the depositors. In addition, Section 779(a) specifically provided that the lower standard could only be applied to federally insured associations.

Knight's willful and malicious conduct is further exemplified by his admsision that during 1963 he became aware of the identities of the officers and directors of the corporation to which City Savings made loans and that "to a certain extent" these same individuals were officers and directors of a majority of the corporations to which City Savings made mortgage loans. Knight, p. 74. In fact, City Savings had extended vast amounts of financing to corporations controlled by essentially the same people. While such financing is not illegal per se, it is certainly highly unusual and when coupled with the massive irregularities uncovered by Mize and Hulman it should have alerted Knight that further investigation was necessary. Knight's failure to probe into the background of these loans enabled Mensik to concentrate 82 percent of the entire loan portfolio of City Savings into the Apple Orchard and Howie in the Hills subdivisions. These loans totaled over $21,000,000 of the association's book assets of $32,000,000. The loans were made to entities controlled by Mensik and Robert Kramer, Mensik's brother-in-law and a vice-president of City Savings, or their nominees. *Tcherepnin v. Franz*, 316 F. Supp. 714 (N.D.Ill. 1970). This was in clear violation of Section 801 of the Illinois Savings and Loan Act which provided, in part:

> No loan shall be made to [an] . . . officer, or director of an associaiton . . . either for himself or as agent, or as partner of another, except upon real estate occupied by such . . . officer, or director as a homestead, or upon the security of withdrawable capital; nor shall any loan be made by an association to any corporation of which a majority of the stock is owned or controlled individually or collectively by any one or more of the directors, [or] officers . . . of such association.

It is clear from these undisputed facts that Knight was fully aware of City Savings' precarious financial position as early as January 1964. It is also painfully evident that the facts underpinning Hulman's report were readily available to Knight, in the form of the Stanley Mize audits, prior to the January 1964 meeting. Yet, incredibly, Knight failed to take any action until April 30 when the Peat, Marwick audit was ordered and did not attempt to correct the massive irregularities pointed out by Hulman and Mize until City Savings was closed on June 26, 1964.

Knight's failure to act decisively prior to June 1964 is rendered even more inexcusable by the fact that he was aware throughout this period that Mensik and City Savings had encountered serious financial difficulties in 1957-59, that City Savings had been unable to secure insurance from the federal government and thus any losses it incurred would fall directly on the depositors and that Mensik had been indicted and convicted for mail fraud in Maryland in November 1963.[9] Knight, pp. 22, 68-69.

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[9] Mensik was first indicted in Baltimore, Maryland for mail fraud in 1958. After extended and complex litigation, he was finally convicted in November 1963. Moreover, on January 16, 1962, Mensik was found by the Tax Court of the United States to have engaged in sundry frauds and irregularities at City Savings. 37 T.C. 703 (1962). This finding of fraud was subsequently affirmed by the Court of Appeals for the Seventh Circuit on February 10, 1964. *Mensik v. C.I.R.*, 328 F.2d 147 (7th Cir. 1964), *cert. denied*, 379 U.S. 827 (1964). These public, reported orders and opinions were all filed before Knight ordered the belated closing of City Savings.

In light of all these undisputed facts, the record is crystal clear, and the court so finds, that Joseph E. Knight willfully and maliciously breached his statutory duty to supervise the affairs of City Savings during the period he served as Director of the Department of Financial Institutions and that he is liable to the depositors of City Savings for any losses incurred as a result thereof. Neither of the parties has addressed the issue of damages and therefore that question shall be reserved for later proceedings.

Count II—Fraud Theory

Count II of the Amended First Cross-Complaint deals with the events surrounding the adoption of the so-called plan of voluntary liquidation in March-July 1964. Named as cross-defendants are the Estate of Knight and Justin Hulman. Throughout this period Joseph E. Knight was Director of the Department of Financial Institutions. Justin Hulman served as technical advisor to Knight regarding savings and loan associations until June 15, 1964, when he was appointed by Knight as Supervisor of Savings and Loan Associations for the Department of Financial Institutions.

The gravamen of Count II is that Knight and Hulman permitted Mensik to foist a fraudulent and illegal plan of voluntary liquidation upon the City Savings depositors. As a result, no judicial supervision over City Savings occurred from June 26, 1964 until Judge Campbell terminated the voluntary liquidation and appointed federal receivers on September 7, 1968. The receiver further alleges that the voluntary liquidators committed many acts of mismanagement during the four-year period they were in control of the City Savings assets and also that Knight and Hulman by reason of their participation in the adoption of the plan are liable to the depositors of City Savings for any losses incurred thereby.

The receiver asserts that Knight's liability may be independently based on either of two factual theories. Under the first, the receiver alleges that Knight, Hulman and Theodore J. Isaacs fraudulently entered into a secret deal with Mensik to impose the illegal voluntary liquidation on the City Savings depositors and that pursuant to that deal the law firm of which Isaacs was a partner was to receive legal fees of $1,000,000. Under the second theory, the receiver contends that even if Knight had been acting in good faith when he endorsed the plan of voluntary liquidation, the plan was contrary to Illinois law and thus Knight is liable for any losses resulting from its adoption.[10]

The receiver's first theory is based primarily upon the testimony of C. Oran Mensik, president, board chairman and chairman of the Executive Committee of City Savings. Mensik, p. 3. Mensik testified that shortly after Peat, Marwick initiated its audit of City Savings he met with State Representative William Pollack. Mensik, pp. 9-10. The pending audit was discussed and Pollack advised Mensik to contact Theodore J. Isaacs, a private attorney in Chicago and former Director of the Department of Revenue for the State of Illinois,[11] whom Pollack thought could "work something out."

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[10] The rule in Illinois is that public officials are not liable to third persons for the misconduct or negligence of their subordinates provided that the official does not direct the acts complained of or personally cooperate in the negligence from which the injury results. *Kelly v. Ogilvie*, 35 Ill.2d 297, 220 N.E.2d 174 (1966); 63 Am.Jur. 2d Public Officers and Employees § 295 (1972). Contrary to the contention of the Estate of Knight, the direct and active participation of Knight under both factual bases supporting Count II has been alleged in both the First Amended Cross-Complaint and in the memorandum filed in support of the motion for summary judgment. Therefore a motion to dismiss based on this contention must be denied.

[11] Isaacs was Illinois Director of Revenue from 1961 to 1963 under former Governor Otto Kerner. On February 19, 1973, Isaacs and Kerner were convicted of a variety of offenses arising out of their activities on behalf of certain Illinois racing interests in return for bribes of more than $150,000. Their convictions were affirmed on appeal. *United States v. Isaacs*, 493 F.2d 1124 (7th Cir. 1974).

Several days later, Mensik visited Isaacs at his office. Mensik, pp. 11-12. Mensik explained the difficulties City Savings had encountered with the Department of Financial Institutions and that Representative Pollack suggested that Isaacs may be able to work out a solution. Mensik, pp. 13-14. Mensik offered Isaacs a City Savings check for $5,000 if he would act as the association's attorney in this matter. Mensik, pp. 65-66. Isaacs refused, saying that the $5,000 was not enough for "attorney's fees." Mensik, pp. 13-14. Isaacs then told Mensik to see Justin Hulman and that Hulman would have a "deal" for him. Mensik, p. 14. Isaacs said, "Don't worry about anything. . . . We'll work it out. . . . You'll get your details from Mr. Hulman." Mensik, pp. 13-14.

Subsequent to this conversation, Mensik had four or five meetings with Hulman, the first occurring in May 1964.[12] At the first meeting, Hulman and Donald Swope discussed City Savings' deteriorating financial condition with Mensik and advised him that they felt that City Savings was in serious trouble. Mensik, pp. 16-17; Hulman, pp. 78-83. Of particular concern were the appraisals made on the Apple Orchard and Howie in the Hills developments and City Savings' practice of crediting income to its books each time it refinanced prior loans.

In the second meeting, 10 days to two weeks later, Hulman handed over to Mensik a copy of the Peat, Marwick audit and told Mensik that City Savings would have to be closed. Mensik, pp. 18-19. Hulman rejected the idea of a court-supervised receivership in favor of placing City Savings in "voluntary liquidation." Hulman noted that if City Savings was placed into receivership, a 3 percent fee would have to be paid to the receivers. Mensik, pp. 19-20. It was at this point that the alleged deal was proposed by Hulman.

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[12] With the exception of the alleged deal, Hulman's account of these conversations generally corresponds with Mensik's. Hulman, pp. 78-84; 92-95; 99-102; 106-107.

There were to be three "voluntary liquidators", two of whom would be state examiners and employees of the Department of Financial Institutions and the third would be a Mensik appointee. Mensik, pp. 19-20. The State of Illinois would assume clerical and other costs of the liquidation, including the salaries of its own employees. Mensik, pp. 19-20. Mensik was to be responsible for securing the necessary approval from the City Savings depositors. Mensik, p. 20. The 3 percent fee which normally would have been paid to receivers was to be paid to the Isaacs law firm for representing the liquidators. Mensik, p. 20. In return, Mensik was to retain any income derived from the placement of property insurance on homes City Savings held mortgages on—approximately $35,000 per year. In addition, Mensik would continue to operate the City Safe Deposit Company, a separate business entity from City Savings which rented safe deposit boxes to depositors. Mensik, pp. 21-22. When asked if this was the "deal" Isaacs had referred to, Hulman replied, "This is the deal." Mensik, p. 20. Mensik told Hulman that he would think it over and call him in another week or so. Mensik, p. 20.

At the third meeting, Mensik agreed to the plan of voluntary liquidation but insisted that $2,000,000 be set aside to complete the Apple Orchard and Howie in the Hills subdivisions. It is unclear from Mensik's testimony whether Hulman agreed to this additional provision. Mensik, p. 24.

The last two conversations took place in the latter part of June 1964 when Hulman called Mensik and asked him to come to his office to discuss further the plan of liquidation. Mensik, pp. 25-28. Mensik refused on each occasion and on June 26, 1964, state examiners took custody of City Savings. Mensik, p. 28.

On July 28, 1964, Mensik called a meeting of City Savings depositors to obtain their approval of the plan of voluntary liquidation. This meeting was attended by Department of Finan-

cial Institutions employees Harry Hulman and Dennis Kirby and Assistant Attorney General Robert Meersman. Knight, p. 35; Hulman, p. 137. At this meeting, one of the attorneys for City Savings told the depositors:

> It is the considered opinion of the management and everybody connected with it that if an orderly liquidation takes place such as we propose, a voluntary liquidation under the plan that we have submitted to you, that you folks will get every nickel of your money and there will be some money left for the declaration of a dividend. [Trannscript of Shareholders' Meeting held July 28, 1964, p. 33.]

In addition, Mensik personally assured the depositors that they would receive "100 cents on the dollar" plus interest if the plan was adopted. Hulman, p. 136; Transcript of Shareholders' Meeting held July 28, 1964, p. 6.

Although the plan of liquidation was prepared by Robert Sharfman, an assistant Attorney General of the State of Illinois,[13] Sharfman, pp. 35-40, and endorsed by Hulman and Knight, Hulman, p. 113; Knight, pp. 76-79, when the Department of Financial Institutions' representative at the meeting, Assistant Attorney General Robert Meersman, was asked by a depositor to give the State's view of the plan, he responded, "The State of Illinois, at this time, takes no interest in this meeting until such time as the liquidation plan is approved. At that time, the State will take active control." Transcript of Shareholders' Meeting held July 28, 1964, p. 65. Meersman made no attempt to interrupt, clarify or correct the fraudulent statements made by Mensik and his attorney.

Both Knight and Hulman admittedly read the transcript of the meeting and heard reports of Mensik's representations.

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[18] See (A. 50-52), *infra*.

Hulman, pp. 118-119; Knight, pp. 35-36. Although both realized that the representations were grossly fraudulent, neither attempted to correct Mensik's statements or advise the depositors that they could never receive 100 cents on the dollar plus interest as a result of the plan. Knight, pp. 37, 79; Hulman p. 37.

The plan of voluntary liquidation was approved by a majority of the depositors present at the meeting, with Mensik voting his fraudulently solicited proxies in favor of the plan. Knight, pp. 76-77. On September 11, 1964, state custody of City Savings was terminated. Legislative Report, p. 18.

Pursuant to the plan, Knight appointed two liquidators, Dennis Kirby and Harry P. Hartman, and Mensik appointed the third, Louis Kwasman. Kwasman was a business associate of Mensik and had supplied City Savings with the premiums which were given away to entice new depositors. Mensik, pp. 66-68. Throughout the liquidation, Kwasman acted as Mensik's personal representative. Mensik, pp. 29-41. Knight then appointed Seymour Burton to represent the depositors. At that time Burton was a partner of Theodore Isaacs. Knight, pp. 47-49.

Mensik claimed that he was "double-crossed" by the state officials. He was not permitted to operate the City Safe Deposit Company nor did he receive any commissions from the placement of property insurance. Mensik, pp. 100-101. Seymour Burton, however, did receive nearly $450,000 in legal fees for representing the liquidators prior to the appointment of the federal receivers. Report of Special Master Milton Gray dated July 25, 1974, p. 72.

Clearly, the receiver has alleged instances of official misconduct committed with Knight's complicity which, if true, were tainted with fraudulent, malicious and corrupt motives and are

sufficient to overcome a motion to dismiss. It is also evident that the commission of these acts breached a statutory duty owed directly to the depositors of City Savings. *State v. American Surety Co.*, 26 Idaho 652, 145 P. 1097 (1914).

However, the state officials involved, Joseph Knight and Justin Hulman, as well as Theodore Isaacs have categorically denied any participation in a "deal" to defraud the depositors of City Savings. Hulman, pp. 151-53; Knight, pp. 75-77. Therefore, for the purposes of the receiver's motion for summary judgment, the court must determine if Knight's acquiescence in the fraudulent representations made at the July 28, 1964 depositors' meeting was sufficient to constitute actual fraud on his part.

In order to sustain an action for fraud it must be established that the defendant made false representations as to a material fact, knowing or believing it to be untrue, with the intent to deceive the plaintiff and that the plaintiff believed these representations reasonably relied on them and acted on them to his injury. **Johnston v. Shockey,** 335 Ill. 363, 167 N.E. 54 (1929); **Davis v. Nehf,** 14 Ill.App.3d 318, 302 N.E.2d 382 (1st Dist. 1973).

Fraud may consist of the concealment or suppression of the truth as well as the positive assertion of a falsehood. **Lagen v. Lagen,** 14 Ill.App.3d 74, 302 N.E.2d 201 (1st Dist. 1973). It is unnecessary that the defendant in an action for fraud have any interest in the result of the fraud, or should derive any benefit from it. *Bergman & Lefkow Ins. Agency v. Flash Cab Co.*, 110 Ill.App.2d 415, 249 N.E.2d 729 (1st Dist. 1969).

In applying these standards to Knight's conduct, the court is, of course, mindful of Knight's special status as a public official and that he cannot be held accountable for his conduct in office without a showing of malice. However, one of the indispensable elements of fraud is the existence of fraudulent intent or intent

to deceive. *Lickus v. O'Donnell*, 321 Ill.App. 144, 52 N.E.2d 271 (2d Dist. 1943). This element coupled with the requisite scienter is, in the opinion of the court, sufficient to establish malicious intent.

Although the fraudulent promises upon which the depositors relied were made by Mensik or his attorneys, the imposition of the plan of voluntary liquidation could not have been accomplished without the passive acquiescence of the state officials at the meeting and Knight's subsequent silence. The law is clear that a person who, by his conduct, contributes to the misapprehension of another as to a material matter, and intentionally fails to correct the misapprehension, is guilty of fraud. *Mitchell v. McDougall*, 62 Ill. 498 (1872); *Endsley v. Johns*, 120 Ill. 469, 12 N.E. 247 (1887); *Bell v. Felt*, 102 Ill.App. 218 (1st Dist. 1902), *modified on other grounds sub nom. Felt v. Belt*, 205 Ill. 213, 68 N.E. 794 (1903). *See Piff v. Berresheim*, 405 Ill. 617, 92 N.E.2d 113 (1950); *Creighton v. Elgin*, 395 Ill. 87, 69 N.E.2d 501 (1946).

Knight's failure to correct the misrepresentations of Mensik and his attorneys is rendered even more culpable by his status as a public official. As Director of the Department of Financial Institutions, Knight had at a minimum a duty to ensure that state-chartered savings and loan associations were operated "only by associations organized and conducted in accordance with the authority provided in [the Savings and Loan] Act," Ill.Rev.Stat. 1963, ch. 32, § 702(b), and thereby safeguard the investments of the depositors of those institutions. *State v. American Surety Co.*, 26 Idaho 652, 145 P. 1097 (1914). By at least June 26, 1964, the date the State took custody of the assets of City Savings, the relationship between Knight and the depositors became that of fiduciary-beneficiary. *Whitbeck v. Ramsay's Estate*, 74 Ill.App. 524 (4th Dist. 1896). As a fiduciary, Knight had a duty of full and complete disclosure. It has been held that while mere silence does not usually amount

to fraud, where the defendant has a duty to speak his failure to correct a material misapprehension constitutes actual fraud. *Racine Fuel Co. v. Rawlins*, 377 Ill. 375, 36 N.E.2d 710 (1941); *Forest Preserve Dist. of Cook County v. Christopher*, 321 Ill.App. 91, 52 N.E.2d 313 (1st Dist. 1944); *Equitable Life Ins. Co. of Iowa v. Halsey, Stuart & Co.*, 112 F.2d 302 (7th Cir. 1940), *rev'd on other grounds*, 312 U.S. 410 (1941).

For these reasons, the court is of the opinion that the receiver's motion for summary judgment must be granted as to Count II. This conclusion finds further support in the receiver's second factual basis for summary judgment—the statutory violation theory.

Count II—Statutory Violation Theory

Section 921 of the Illinois Savings and Loan Act, Ill.Rev. Stat. 1963, ch. 32, § 921, provided that if any one or more of the reasons for taking custody of a savings and loan association continues through the period of custody, the Director of the Department of Financial Institutions shall appoint a receiver:

> If the Director, after taking custody of an association . . . finds that any one or more of the reasons for taking custody continues to exist through the period of his custody, then he shall appoint any qualified person, firm or corporation as receiver or co-receiver of such assocation or trust for the purpose of liquidation.

In addition, Section 922 of that Act provided:

> After so appointing a receiver, the Director [of the Department of Financial Institutions] shall direct the Attorney General to file a complaint in equity in the name of the Director in the circuit or superior court of the

> county in which such association or trust is located and against the association or trustees or liquidators, as the case may be, for the orderly liquidation and dissolution of the association or trust and for an injunction restraining the officers, directors, trustees, or liquidators, from continuing the operation of the association or trust.

These provisions prescribed a statutory duty owed by the Director of the Department of Financial Institutions directly to the depositors of City Savings. *State v. American Surety Co.*, 26 Idaho 652, 145 P. 1097 (1914).

Hulman and Knight have testified that the State took custody of City Savings for all the reasons enumerated in Section 848 of the Illinois Savings and Loan Act, Ill.Rev.Stat. 1963, ch. 32, § 848. Knight, pp. 37-40; Hulman, pp. 107-111. That section provided, in relevant part:

> The Director [of the Department of Financial Institutions] in his discretion may take custody of the books, records and assets of . . . any association . . . if it appears from reports made to the Director, or from examination made by or on behalf of the Director:
>
> (a) That the directors, officers, trustees, or liquidators have neglected, failed or refused to take any action which the Director may deem necessary for the protection of the association or trust, or have impeded or obstructed an examination; or
>
> (b) That the withdrawable capital of the association is impaired to the extent that the realizable value of its assets is insufficient to pay in full its creditors and holders of its withdrawable capital; or that its permanent reserve capital is impaired; or
>
> (c) That the association is unable to continue operations; or

(d) That the business of the association, trust, or association in liquidation is being conducted in a fraudulent, illegal, or unsafe manner; or

(e) That the officers, employees, trustees, or liquidators have continued to assume duties or perform acts without giving bond as required by the provisions of this Act.

Hulman further testified that the State closed City Savings on June 3, 1964 for two reasons: (1) the Association was unable to pay a dividend because of its capital impairment; and (2) the Association "had completely run out of money." Hulman, p. 111.

Both Knight and Hulman stated that at the time of the adoption of the voluntary liquidation plan by the depositors as well as at the time the assets of City Savings were transferred to the voluntary liquidators, September 11, 1964, none of the conditions precipitating the State's taking custody of City Savings were cured. Knight, p. 40; Hulman, pp. 88-100. Yet, in direct contradiction of Sections 921 and 922 of the Illinois Savings and Loan Act, Knight failed to: (1) appoint a receiver for City Savings; (2) direct the Attorney General to file a complaint against City Savings to ensure an orderly dissolution; or (3) direct the Attorney General to seek an injunction restraining the officers and directors of City Savings from continuing operations. Knight, pp. 46-47.

Knight contends that he is not responsible for any possible illegalities contained in the plan of voluntary liquidation because he is not an attorney and because in recommending the plan he relied upon the legal advice of the Illinois Attorney General. Knight, pp. 92-93. In 1964, the Illinois Attorney General was William G. Clark. Clark has testified that he could not recall either researching the Illinois Savings and Loan Act to determine if the plan was legal or discussing the City Savings situation with Knight or any other state official. Clark, pp. 14, 29-30. Clark did indicate that Robert Sharfman, then an assistant Attorney General, prepared the plan. Clark, p. 12.

Sharfman testified that he was first employed by the Attorney General in November 1963. Sharfman, p. 4. Sharfman's first contact with the Department of Financial Institutions was in 1964 when he was asked to prepare the plan of voluntary liquidation for City Savings. Sharfman, pp. 6-7. At that time, Sharfman freely admitted to the Department officials that he "didn't have the slightest idea of what a paln involves or what to do." Sharfman, p. 7. Sharfman's actual role in the preparation of the plan came to light during cross-examination by the receiver's attorney:

By Mr. Serritella:

Q. Did you in fact do more than change the names and dates of the old plan?

A. I did nothing more than that. If you check the plan of Beverly or Tinley Park and check the plan here, you will see they are identical word for word with the exception of three [liquidators instead of two.]

Q. You did not decide that City Savings was to have a voluntary liquidation, is that correct?

A. That wasn't my decision.

Q. You were just told, prepare the plan and this is the plan that you were supposed to prepare, is that correct?

A. I think that is my recollection, yes, that is my recollection. Now, I think others would have a different opinion, by the way. I don't remember ever being asked about what is proper at that time.

Q. Do you have a recollection of doing any legal research as to whether or not the plan was proper as with respect to City Savings?

A. No, I don't. . . .

Q. You don't recall doing any research yourself as to whether or not the plan was proper with respect to City Savings?

A. I remember just looking at the section and saying what should be in the plan, not whether the plan should be adopted.

Q. You never wrote a legal memo on the subject?

A. I don't believe I ever wrote—I don't believe I ever wrote a legal memo in this case at all . . . [Sharfman, pp. 36-38.]

The record is clear, and the court so finds, that Knight did not rely upon the advice of the Attorney General or his assistants in preparing the plan of voluntary liquidation. It is equally clear that Knight, in permitting the adoption of the plan, breached his statutory duties prescribed under Sections 921 and 922 of the Illinois Savings and Loan Act.

The law is well established that where a duty imposed on a public official is purely ministerial, and does not involve the exercise of discretion, the official is liable for injuries caused by the negligent performance of that duty. *People ex rel. Munson v. Bartels*, 138 Ill. 322, 27 N.E. 1091 (1891); *Thiele v. Kennedy*, 18 Ill.App.3d 465, 309 N.E.2d 394 (3d Dist. 1974); *Anderberg v. Newman*, 5 Ill.App.3d 736, 283 N.E.2d 904 (1st Dist. 1972); *Lusietto v. Kingan*, 107 Ill.App.2d 239, 246 N.E.2d 24 (3d Dist. 1969); 63 Am.Jur.2d *Public* Officers and Employees §§ 292-293 (1972).

It has been held that the failure of a public official to perform an act required by statute constitutes an actionable breach of a ministerial duty and renders him liable for all damages resulting therefrom. *People ex rel. Pope County v. Shelter*, 318 Ill.App. 279, 47 N.E.2d 732 (4th Dist. 1943); *Button v. Nevin*, 44 Ariz. 247, 36 P.2d 568 (1934); *State v. Title Guaranty & Surety Co. of Scranton*, 27 Idaho 752, 152 P. 189 (1915); see *Fidelity & Casualty Co. of New York v. Brightman*, 53 F.2d 161 (8th Cir. 1931).

In sum, the court finds that there is no genuine issue of material fact; that Knight willfully disregarded his clear statutory duties set out in Sections 921 and 922 of the Illinois Savings and Loan Act; and that the Estate of Knight is liable to the depositors of City Savings for any damages resulting therefrom. The issue of damages has not been addressed by the parties and is reserved for later ruling.

Count III

Count III involves two transactions occurring during the period June-September 1964 when the State was in custody of City Savings. Named as cross-defendants are the Estate of Knight and Justin Hulman. Throughout this period Joseph E. Knight was Director of the Department of Financial Institutions and Justin Hulman was Supervisor of Savings and Loan Associations for the Department. The receiver has orally withdrawn his motion for summary judgment as to Count III and as a result the court need only consider the Estate of Knight's motion to dismiss.

Section 853 of the Illinois Savings and Loan Act, Ill.Rev. Stat. 1963, ch. 32, § 853, required the Director of the Department of Financial Institutions to segregate in a separate account all funds deposited in a savings and loan association during the period it is in state custody. Section 853 further provided that before turning over the assets of an association to a liquidator or receiver the Director "shall" return any monies collected from depositors during the period of state custody.

Count III alleges that from June 26 to June 30, 1964, during the initial period of state custody, approximately $185,000 was deposited in City Savings. Hulman Answer to First Amended Cross-Complaint, p. 8. Rather than segregate these funds in a separate account as required by Section 853, Hulman, acting under Knight's supervision, directed that they be deposited in an existing City Savings account at Manufacturers National Bank. Hulman, p. 146; Transcript of Proceedings held on August 19 to 23, 1968, pp. 394-395. Manufacturers National Bank was a creditor of City Savings; it immediately exercised its right of set-off and seized these funds.

The Estate of Knight contends that Count III fails to state a cause of action because: 1) there are no allegations of malicious or reckless conduct; 2) the duties prescribed in Section 853 are owed to the State of Illinois and not to the depositors; and 3) the payment to Manufacturers National Bank was neither illegal nor wrongful.

It is well established that the failure of a public official to perform an act required by statute constitutes an actionable breach of a ministerial duty and renders him liable for all damages resulting therefrom. Malicious or reckless conduct need not be alleged. *People ex rel. Pope County v. Shelter*, 318 Ill. App. 279, 47 N.E.2d 732 (4th Dist. 1943); *Button v. Nevin*, 44 Ariz. 247, 36 P.2d 568 (1934); *State v. Title Guaranty & Surety Co. of Scranton*, 27 Idaho 752, 152 P. 189 (1915).

It is clear that, if Knight's failure to segregate the deposits received during the state custody of City Savings is established, it constituted an actionable breach of a ministerial duty. Further, it is obvious even from a cursory reading of the statute, that the provisions of Section 853 were enacted to protect the depositors of seized savings and loan associations. For these reasons, the Estate of Knight's motion to dismiss this portion of Count III must be denied.

Count III also alleges that Knight and Hulman in 1964 unlawfully sold various assets of City Savings in order to pay approximately $150,000 to the Central National Bank of Chicago and approximately $100,000 to the Oak Park National Bank of Chicago even though these banks had neither filed claims nor obtained judgments against City Savings.

The rule in Illinois is that a public official is the insurer of monies which properly come into his possession. *Barrett v. Bradford*, 372 Ill. 63, 22 N.E.2d 691 (1939); *Ramsay v. Southern Illinois Penitentiary*, 197 Ill. 572, 64 N.E. 549 (1902). This rule applies equally whether the funds involved are denominated public or private. *Hoyt v. McGrath*, 279 Ill. 560, 117 N.E. 147 (1917).

Thus, if these assets were unlawfully sold, Knight would be liable for any losses incurred as a result thereof. The receiver, however, has failed to explain why he contends that the sale of these assets was unlawful. The court tentatively denies the Estate of Knight's motion to dismiss this portion of Count III and grants the receiver 10 days within which to file a supplemental brief explaining the legal theory supporting these allegations. The Estate of Knight is granted 10 days within which to reply.

It is therefore ordered that the Estate of Knight's motion to dismiss Counts I, II and III of the Amended First Cross-Complaint shall be, and the same is hereby, denied.

It is further ordered that Justin Hulman's motion to dismiss Counts I, II and III of the Amended First Cross-Complaint shall be, and the same is hereby, denied.

It is further ordered that the receiver is granted 10 days within which to file a supplemental brief explaining the legal theory supporting certain allegations contained in Count III.

It is further ordered that the receiver's motion for summary judgment against the Estate of Knight on Counts I, II and III of the Amended First Cross-Complaint is granted as to Counts I and II and denied, at this time, as to Count III.

It is further ordered that any issues of damages raised by this court's entry of summary judgment on Counts I and II of the Amended First Cross-Complaint shall be reserved for future proceedings.

/s/ EDWIN A. ROBSON
Chief Judge

April 14, 1975

APPENDIX C

United States District Court
Northern District of Illinois
Eastern Division

Alexander Tcherepnin, et al.,
Plaintiffs,
v.
Robert Franz, et al.,
Defendants.
No. 64 C 1285

MEMORANDUM AND ORDER

(Dated November 30, 1976)

This cause is before the court on the objections of cross-defendant First National Bank and Trust Company in Alton, executor of the estate of Joseph E. Knight, deceased (Estate of Knight), to the Report of Special Master Milton H. Gray[1] and on the motion of the receiver to adopt said Report. For the reasons hereinafter stated, the Report shall be accepted and the Special Master's findings of fact and conclusions of law shall be adopted as those of this court.

On April 14, 1975, this court entered a memorandum and order which, *inter alia*, granted in part the receiver's motion for summary judgment and held the Estate of Knight liable under Count I and Count II of the receiver's Amended First

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[1] On July 9, 1976, Master Gray filed a thirty-three page document entitled "Report of Special Master, Milton H. Gray, Including Findings Of Facts, Conclusions Of Law, And Recommendations In Respect To The Determination of Damages Against Cross-Defendant First National Bank And Trust Company In Alton, As Executor Of The Estate of Joseph E. Knight, Deceased." Same will be referred to in the text of this opinion as the "Report."

Cross-Complaint. *Tcherepnin v. Franz*, 393 F. Supp. 1197 (N.D. Ill. 1975). The opinion reserved the issue of damages for future proceedings. 393 F. Supp. at 1213, 1220-21. On May 8, 1975, an order was entered referring the damage issue to Special Master Milton H. Gray (Master Gray) for hearing and report to this court. In accord with this order, hearings were held, memoranda were filed and on July 9, 1976, Master Gray filed his Report.

On July 22, 1976, the Estate of Knight filed its objections to Master Gray's Report. Six days later, the receiver filed a motion to adopt the Report. Pursuant to this court's directive, the Estate of Knight filed a segregated set of objections to the Report on August 9, 1976. Thereafter, on August 31, 1976, the receiver filed a memorandum in support of his motion. On October 8, 1976, a hearing was held on this matter and the Estate of Knight filed a memorandum in reply to the receiver's.

At issue before Master Gray was the damages recoverable against the Estate of Knight under Count I of the Amended First Cross-Complaint.[2] This court found Knight liable under this count as he willfully and maliciously disregarded his statutory duty to supervise the affairs of City Savings during the period in which he served as Director of the Department of Financial Institutions. 393 F. Supp. at 1213. During the course of its opinion, the court noted that City Savings loaned over $21,000,000 secured by the so-called Apple Orchard and Howie in the Hills real estate developments and further that these loans, based upon grossly inflated values of the properties,

[2] While summary judgment was granted on both Count I and on Count II of the Amended First Cross-Complaint, the receiver chose to limit his proof to Count I only as he was satisfied that the damages that would be recovered thereunder exceed the value of the Knight estate. Reply Memorandum of the Receiver filed April 9, 1976 at 8 n.

were the single greatest factor in the demise of City Savings. 393 F. Supp. at 1206-07.

Master Gray's Report is divided into nine sections.[3] The Estate of Knight objects to all sections of the Report except sections I and IX. The receiver, on the other hand, has moved the court to adopt the Report in toto. The receiver's motion shall be granted.

The Estate's objections may be conveniently divided into three areas: liability, joint and several recovery and damages. The objections as to liability are overruled. The reference to Master Gray was to the issue of damages. Liability was established by this court's order of April 14, 1975. The Estate of Knight did not file a motion to reconsider this opinion and the arguments advanced as to liability are untimely.[4]

The court, recognizing that the parties are entitled to a "real review" of the evidence submitted to Master Gray, *Locklin v. Day-Glo Color Corporation*, 429 F.2d 873, 876 (7th Cir. 1970), *cert. denied*, 400 U.S. 1020 (1971), and that his conclusions of law carry no weight with this court, further adopts the Report on this issue of joint and several liability. The Estate of Knight objects because the receiver did not allege his cause of action sufficiently so as to apprise cross-defendant of the charges and because the receiver did not

[3] I. Reference and Hearings, I. Counts I and II, III. Significance of Apple Orchard and Howie in the Hills Real Estate Developments, IV. Contentions of the Bank, V. Joint and Several Liability, VI. Findings of Amount of Damages, VII. Recommendations to Overrule Certain Motions and Overruling of Certain Other Motions, VIII. Recommendation of Damages and IX. Submission.

[4] The Estate of Knight contended at the hearing on the Report that "facts were not made aware of [on liability] until we had a hearing [before Master Gray]." Tr. October 8, 1976 at 9. However, a review of the Estate's reply memorandum filed February 4, 1975, indicates that many, if not all, of these facts were raised before liability was established.

advise Knight of what must be met on the issue of damages. Master Gray found these objections to be without merit and the court must agree. Count I of the Amended First Cross-Complaint alleges a breach of official duty by certain cross-defendants and seeks recovery of damages in excess of $14,-000,000. The nature, size and relevancy of the loans made against the Apple Orchard and Howie in the Hills projects are specifically pleaded. Clearly, the Estate has been on notice not only of the cause of action but also of the damages sought thereunder.

The Estate of Knight objects because the Special Master concluded that this cross-defendant is liable in damages jointly and severally. The Estate complains because the receiver failed to plead joint and several liability. It further objects because it suggests that Knight can only be held liable to the extent that his own acts caused the injury of which the receiver complains. Finally, the Estate of Knight suggests that Master Gray is in error as he has found that this cross-defendant can be held liable for a judgment which, at some future date, may be rendered against an unknown person. Such "conjectural probability of future loss" is argued by the Estate of Knight to violate the rules of pleading and the law.

Once again, the court holds the objections of the Estate of Knight to be without merit. Master Gray found that the receiver's failure to plead joint and several liability in *haec verba* did not preclude recovery under this theory where, as here, the "interplay of the separate torts was pleaded with sufficient clarity." Report at 21-22. The court concurs. Joint liability may be charged against a defendant when the pleader alleges that separate torts by separate individuals resulted in an indivisible injury, i.e., the overvalued loans.

Further, the court agrees with Master Gray that the Estate of Knight must be held jointly and severally liable for the

losses incurred as a result of the loans made on the Apple Orchard and Howie in the Hills real estate developments. As the Estate apparently recognizes, a defendant may be held jointly and severally liable for the entire loss caused by two or more tortfeasors when the injury caused is indivisible. Master Gray specifically found, and the court independently holds, that the losses which occurred because of the excessive loans on Apple Orchard and Howie in the Hills resulted in a single, indivisible wrong to the depositors of City Savings.

The Estate of Knight is in error when it argues that Master Gray suggested that this cross-defendant can be held liable for "future loss." Master Gray merely stated that a joint and several judgment could not be entered against the Estate of Knight and other named joint tortfeasors when, as here, no other individuals have as yet been held specifically liable for losses incurred as a result of the Apple Orchard and Howie in the Hills loans. The court agrees. Nevertheless, when as in the instant situation, the injury caused by Knight is indivisible, joint and several liability must be imposed against this cross-defendant even though others have not as yet been brought to judgment. *Wabash, St. Louis and Pacific Railway Co. v. Shacklet*, 105 Ill. 364, 381 (1883); *Pearman v. Morris*, 15 Ill. App. 2d 486, 494, 146 N.E.2d 589, 593 (3d Dist. 1957).

In his Report, Master Gray made ten findings with respect to damages. The court has thoroughly reviewed each. They are clearly supported by the evidence and the law and these findings shall be adopted by the court.[5]

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[5] Master Gray's damage finding number 2 (Report at 24) refers to loans approved before or during Knight's tenure as Director of Financial Institutions. As Master Gray's reference to Receiver's Exhibit 2 makes clear, these amounts represent the outstanding balances of authorized loans as shown by the records of City Savings on September 7, 1968. *See* Tr. July 8, 1975 at 44-8 and Receiver's Exhibit 2.

The Estate of Knight has made "formal objection" to six of the ten findings at issue. Objections to findings 3, 4, 5 and 6 must be summarily overruled. These findings were made by this court in its memorandum and order of April 14, 1975. They were, and are, clearly supported by the record in this cause and could not be ignored by Master Gray as the Estate seems to suggest. Further, as the receiver notes in his memorandum, findings 4-6 were not used by Master Gray in the calculation of damages.

The Estate of Knight objects to Master Gray's findings that City Savings and its depositors were damaged in the amount of $14,274,304 as a result of the loans made on the Apple Orchard and Howie in the Hills projects and that the Estate of Knight is liable therefor. The Estate asserts, *inter alia*, that these findings are speculative. The court disagrees. Master Gray based the damage amount on: (a) an actual realized book value loss; and (b) precise figures of book value and proceeds of sale as of these same dates. Report at 28. This figure is clearly supported by the testimony and evidence submitted to Master Gray. Tr. June 23, 1975 at 12-13; Price Waterhouse & Co. Report of June 9, 1975, Note 4.

The Estate of Knight further objects to this figure because the properties at issue were not sold until 1973-74 during a period of recession. As Master Gray noted, however, the intervening years were in part a result of the judicial appellate process and, in any event, apparently worked to the benefit of the Estate. Report at 29.

In addition, the Estate of Knight argues that it should not be held liable for the damages resulting from these loans as Knight's first written knowledge of City Saving's insolvency was received in June 1964. This argument, however, is irrelevant. Knight was found liable as he willfully and maliciously breached his statutory duty to supervise the affairs of City Savings. *Tcherepnin v. Franz*, 393 F. Supp. 1197, 1210-13 (N.D.

Ill. 1975). Further, Knight had knowledge of the overvalued loans no later than January 1, 1964. 393 F. Supp. at 1210. Master Gray found that between this date and June 30, 1964, City Savings disbursed $1,172,623.33 in loans in respect to Apple Orchard and Howie in the Hills. Report at 22-23. That finding is specifically adopted by the court as it is clearly supported by the record. *See* Report at 22-24 and evidence cited.

Finally, the Estate objects because no appraisals were introduced before Master Gray. The court fails to see the relevance of this objection. In any event, the record reveals that appraisals were in fact ordered by Judge Campbell in April 1972 and that same were filed with the court on May 22, 1972 and on June 20, 1972. Thereafter the properties at issue were sold only after court approval.

Master Gray recommended damages in the amount of $14,274,304 in the Report of July 9, 1976. For the reasons heretofore stated, that figure is hereby adopted by the court. However, the subsequent Price Waterhouse & Co. Report of September 10, 1976, filed with the court on October 4, 1976, indicates that the book loss on the Howie in the Hills property has been reduced by $224,800 as of December 31, 1975. Price Waterhouse & Co. Report of September 10, 1976, Note 4. In addition, this court ordered that an additional $80,000 be released to City Savings from the Howie in the Hills escrow on July 28, 1976. Accordingly, Master Gray's recommendation of July 9, 1976, has been reduced by $304,800 and judgment is entered against the Estate of Knight in the amount of $13,969,504.

Finally, in section VII of his Report, Master Gray has recommended that his rulings on certain motions be confirmed. The receiver has also recommended that these rulings be adopted by the court. The Estate of Knight, while objecting to certain rulings in its memoranda, has apparently withdrawn all objections save one. Tr. October 8, 1976 at 22.

In any event, the court has reviewed the rulings of Master Gray at issue and hereby confirms same. Master Gray granted the receiver leave to reopen his proof solely to complete the record left open by the Estate of Knight while denying the Estate's objections and motion for leave to file a supplemental answer. Report at 29-32. Clearly Master Gray's rulings in this area were well within his discretion. Fed. R. Civ. P. 53(c).

Master Gray further has recommended that the motion of the Estate of Knight to suppress the deposition testimony of C. Oran Mensik be denied. Report at 32. Finally, he has recommended overruling the motions of the Estate that the Special Master "make a finding and recommendation of no damages caused by said Joseph E. Knight." Report at 33. The recommendations of the Special Master are hereby confirmed by this court. The Mensik testimony is irrelevant on the damage issue and the recommendations of "no damages caused by said Joseph E. Knight" are overruled on the basis of Master Gray's Report herein adopted.

For the reasons stated, it is therefore ordered that the Report of Special Master Milton H. Gray, filed July 9, 1976, shall be, and the same is hereby, accepted and the Special Master's findings of fact and conclusions of law are adopted as those of this court.

It is further ordered that final judgment shall be, and the same is hereby, entered against the First National Bank and Trust Company in Alton, as executor of the estate of Joseph E. Knight, deceased, in the amount of $13,969,504.

/s/ EDWIN A. ROBSON
Senior Judge

November 30, 1976

APPENDIX D

In the United States District Court
For the Northern District of Illinois
Eastern Division

Alexander Tcherepnin, et al.,
Plaintiffs,
v.
Robert Franz, et al.,
Defendants.
} No. 64 C 1285

JUDGMENT

This cause having come on to be heard on motion of Samuel Berke, Receiver of cross-plaintiff City Savings Association, to enter final judgment against the First National Bank and Trust Company in Alton, as executor of the estate of Joseph E. Knight, deceased, pursuant to Rule 54(b) of the Federal Rules of Civil Procedure, the Court having granted the Receiver's motion for summary judgment as to the Bank's liability on Counts I and II of the Receiver's Amended First Cross-Complaint on April 14, 1975 and the Court having adopted the Report of Special Master Milton H. Gray, filed July 9, 1976, with respect to damages to be assessed against the Bank and having ordered that judgment be entered against the Bank in the amount of $13,969,504 on November 30, 1976, and it appearing to the Court that there is no just reason for delay in entering final judgment.

It Is Hereby Ordered and Expressly Directed that final judgment be entered against the First National Bank and Trust

Company in Alton, as executor of the estate of Joseph E. Knight, deceased, in the amount of $13,969,504.

Enter:

EDWIN A. ROBSON
Senior Judge

Dated: December 20, 1976

APPENDIX E

United States District Court
Eastern District of Illinois
Eastern Division

Alexander Tcherepnin, et al.,
Plaintiffs,
v.
Robert Franz, et al.,
Defendants.
No. 64 C 1285

MEMORANDUM AND ORDER

(Dated March 1, 1977)

This cause is before the court on the motion of the First National Bank and Trust Company in Alton, executor of the estate of Joseph E. Knight, deceased, ("Estate of Knight") for a new trial. For the reasons hereinafter stated, the motion shall be denied.

The court will not repeat all of the alleged errors raised by the Estate of Knight in its motion filed December 27, 1976, and in its supporting memoranda. Many of these contentions have been previously considered by the court and expressly rejected. In sum, no new material facts have been raised in either the Estate's motion or in its memoranda. The order granting the receiver's motion for summary judgment cannot be altered on this ground.

The Estate of Knight has raised three matters in its motion for the first time which the court must address as they might appear to have some merit absent clarification. The Estate complains because no hearing was held on the receiver's sum-

mary judgment motion although hearing dates were allegedly set. The Estate further maintains that the court was in error in assessing damages against it without first deducting the $12,467,500 received from the State of Illinois in settlement. Finally, the Estate contends that the liability judgment is erroneous as the court considered matter outside the scope of Rule 56(c) of the Federal Rules of Civil Procedure.

The Estate of Knight has not called the court's attention to any request on the record for a hearing on the receiver's motion for summary judgment prior to the court's decision of April 14, 1975. Rather, it is clear that the Estate was aware that the motion had been taken under advisement without argument pursuant to Local General Rule 13 and consented thereto. *See* Transcript of January 13, 1975. It appears that the further objection of the Estate is that Rule 56 requires a hearing as a matter of law and that the court erred in not holding one even though same was not requested. This proposition is incorrect. *Sarelas v. Porikos*, 320 F.2d 827, 828 (7th Cir. 1963), *cert. denied*, 375 U.S. 985 (1964).

The Estate of Knight further maintains that the court erred in not reducing the damages assessed against it by the amount received in settlement with the State of Illinois. There are at least two reasons why this argument lacks merit. One, the settlement with the State of Illinois provides that any excess monies recovered by the receiver are to be returned to the State of Illinois. *See* Order of October 9, 1973, at 7-8. Two, the Estate has represented to the court "that the marketable assets of Joseph E. Knight Estate are substantially less than one million dollars," affidavit of John J. Gainer filed December 27, 1976, thus negating the possibility of a duplicative recovery.

Finally, the Estate of Knight contends that this court committed error in granting the receiver's motion for summary judgment when it considered the Illinois Legislative Investigating Commission Report, "The Failure of the City Savings Association, a Report to the Illinois General Assembly ("Legislative Report") and its prior order of March 12, 1973, as evidence against the Estate. In fact, however, the court did not rely at all on either the Legislative Report or its order of March 12, 1973, in support of the receiver's motion. *Tcherepnin v. Franz*, 393 F.Supp. 1197 (N.D. Ill. 1975). Rather, summary judgment was premised upon the record consisting primarily of the deposition testimony of Knight and other state officials. *Id.* at 1209-20.

For the reasons stated, it is therefore ordered that the motion of the First National Bank and Trust Company in Alton, executor of the estate of Joseph E. Knight, deceased, for a new trial shall be, and the same is hereby, denied.

/s/ EDWIN A. ROBSON
Senior Judge

March 1, 1977.

APPENDIX F

United States Court of Appeals
For the Seventh Circuit

January 23, 1978

Before

Hon. Luther M. Swygert, Circuit Judge

Hon. Walter J. Cummings, Circuit Judge

Hon. William J. Bauer, Circuit Judge

Appeal No. 77-1582

Alexander Tcherepnin, et al., Plaintiffs, v. Robert Franz, et al., Defendants. Samuel Berke, Receiver of City Savings Association, Cross-Plaintiff, Appellee, v. First National Bank and Trust Company in Alton, Executor of the Estate of Joseph E. Knight, Cross-Defendant, Appellant.	Appeal from the United States District Court for the Northern District of Illinois, Eastern Division. No. 64-C-1285. Edwin A. Robson, Judge.

This cause came on to be heard on the transcript of the record from the United States District Court for the Northern District of Illinois, Eastern Division, and was argued by counsel.

On consideration whereof, it is ordered and adjudged by this court that the judgment of the said District Court in this cause appealed from be, and the same is hereby, Affirmed, with costs, in accordance with the opinion of this court filed this date.

APPENDIX G

United States Court of Appeals
For the Seventh Circuit

February 24, 1978

Before

Hon. Luther M. Swygert, Circuit Judge

Hon. Walter J. Cummings, Circuit Judge

Hon. William J. Bauer, Circuit Judge

Alexander Tcherepnin, et al.,
Plaintiffs,

No. 77-1582. vs.

Robert Franz, et al.,
Defendants.

Samuel Berke, Receiver of City Savings Association,
Cross-Plaintiff, Appellee,

vs.

First National Bank and Trust Company in Alton, Executor of the Estate of Joseph E. Knight,
Cross-Defendant, Appellant.

On Petition for Rehearing and Suggestion for Rehearing En Banc.

ORDER

On consideration of the petition for rehearing and suggestion for rehearing en banc filed in the above entitled cause by First National Bank and Trust Company in Alton, Executor of the

Estate of Joseph E. Knight, Appellant, no judge in active service has requested a vote thereon,* and all of the judges on the original panel have voted to deny a rehearing. Accordingly,

It Is Ordered that the aforesaid petition for rehearing be, and the same is hereby, Denied.

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* The Hon. Robert A. Sprecher and The Hon. Philip W. Tone did not participate in the consideration of the above petition for rehearing and suggestion for rehearing en banc.

APPENDIX H

Excerpts From Illinois Savings and Loan Act.

Ill. Rev. Stat. 1963, Vol. 1, Ch. 32, pp. 1262-1288 provides in part:

ILLINOIS SAVINGS AND LOAN ACT

AN ACT to revise and codify the laws in relation to Savings and Loan Associations and to provide penalties for the violation thereof, and to repeal an Act therein named. Approved July 5, 1955. L. 1955, p. 849.

Be it enacted by the People of the State of Illinois, represented in the General Assembly:

ARTICLE 1. GENERAL PROVISIONS

701. (p. 1262). § 1-1. *Short Title.* This Act shall be known and may be cited as the "Illinois Savings and Loan Act."

702. (p. 1263). § 1-2. *Policy of Act.* The General Assembly has found and declares:

(a) That the savings and loan business, otherwise known as the building, loan, and homestead business, which is within the scope of this Act, has so expanded in recent years, and has become so integrated with the financial institutions of this State and is so important as a method of promoting home ownership and thrift, that such business, to an even greater extent than heretofore, is affected with a public interest and should continue to be supervised as a business affecting the economic security and general welfare of the people of this State;

(b) That such business should be operated only by associations organized and conducted in accordance with the authority provided in this Act;

(c) That the number and minimum size of the associations conducting such business should be controlled in the interest of securely and efficiently serving the needs of the localities in which they operate;

(d) That the public interest requires the promotion and fostering of the savings and loan, or building, loan, and homestead business and the assurance of its financial stability;

(e) That in order to further the policies herein expressed, the provisions of this Act shall be liberally construed to promote and foster the purposes of savings and loan associations.

• • • • • • • •

710. (p. 1263). § 1-10. *Definitions.* The following words and phrases have the following respective definitions for the purpose of this Act, except to the extent that any such word or phrase is specifically qualified by its context:

• • • • • • • •

(d) "Director": The Director of Financial Institutions, or some person authorized by him to act in his stead.

• • • • • • • •

(p. 1280) ARTICLE 7. SUPERVISION

• • • • • • • •

848. (p. 1281). § 7-8. *Director's Authority to Take Custody.* The Director in his discretion may take custody of the books, records and assets of every kind and character of any association, trust, or association in liquidation, for any of the purposes hereinafter enumerated, if it appears from reports made to the

Director, or from examination made by or on behalf of the Director:

(a) That the directors, officers, trustees, or liquidators have neglected, failed or refused to take any action which the Director may deem necessary for the protection of the association or trust, or have impeded or obstructed an examination; or

(b) That the withdrawable capital of the association is impaired to the extent that the realizable value of its assets is insufficient to pay in full its creditors and holders of its withdrawable capital; or that its permanent reserve capital is impaired; or

(c) That the association is unable to continue operations; or (p. 1282) (d) That the business of the association, trust, or association in liquidation is being conducted in a fraudulent, illegal, or unsafe manner; or

(e) That the officers, employees, trustees, or liquidators have continued to assume duties or perform acts without giving bond as required by the provisions of this Act.

Unless the Director finds that an emergency exists which may result in loss to members or creditors and requires that he take custody immediately, he first shall give written notice to the directors, trustees, or liquidators specifying the conditions criticized and state a reasonable time within which correction may be made. As amended by act approved July 24, 1959. L.1959, p. 2396.

849. (p. 1282) § 7-9. *Purposes of Taking Custody.* The purposes of taking such custody of an association or trust may be examination; further examination; conserving of its assets; restoration of impaired capital; the making of any necessary or equitable adjustment deemed necessary by the Director under any plan of reorganization; or liquidation; or the maturing of the obligation of the insurance corporation. As amended by act approved June 4, 1957. L.1957, p. 433.

850. (p. 1282) § 7-10. *Director's Powers During Custody.* During the period in which the Director has such custody, the Director has all powers which are necessary or appropriate to accomplish the purposes of taking custody, including (but not limited to) the authority:

(a) To operate the business of the association, except as limited by the other subsections of this section; exercising for that purpose all of the rights, powers, and privileges possessed by the officers and directors, liquidators, or trustees;

* * * * * * *

854. (p. 1282) § 7-14. *Redelivery of Possession.* If after examination of the association and consideration of all conditions affecting its affairs, the Director finds that the cause or causes for taking custody have been removed, he shall relinquish custody of the association and redeliver the same and all assets, books and records thereof to the directors of the association or to the trustees or liquidators qualified to accept the same. As amended by act approved June 4, 1957, L.1957, p. 433.

* * * * * * *

855. (pp. 1282-83) § 7-15. *Limitations Upon Custody.* The custody of an association by the Director may be continued for a reasonable period not to exceed six (6) months, unless further extension shall be agreed upon by a vote of two-thirds (⅔) of the directors of the association or upon application for such extension and by order entered in a court of competent jurisdiction. As amended by act approved June 4, 1957. L. 1957, p. 433.

* * * * * * *

ARTICLE 9. VOLUNTARY LIQUIDATION

901. (p. 1285) § 9-1. *Authority to Liquidate.* An association may liquidate voluntarily in accordance with a plan of voluntary liquidation which has been adopted in the manner provided in this article.

902. (pp. 1285-86) § 9-2. *Decision as to Liquidation; Adoption of Plan.* (a) At any annual or special meeting of the members, the members may vote to liquidate the association, and may adopt a plan of liquidation which has been approved by the board of directors, or proposed by one or more shareholders, or submitted by the Director; or may elect a committee of three (3) persons to prepare and submit a plan, and thereafter may adopt such plan. However, no plan except one submitted by the Director shall be adopted unless it has been filed with the Director at least five (5) days before the vote of the members is taken thereon.

(b) A plan will be adopted upon receiving in the affirmative two-thirds (⅔) or more of the total number of votes which all members of the association are entitled to cast. As amended by act approved June 4, 1957. L.1957, p. 433.

903. (p. 1286) § 9-3. *Plan of Voluntary Liquidation.* The plan of voluntary liquidation shall provide for the full liquidation of the association, setting forth the powers, duties, manner of filling vacancies, and succession of the liquidators and authorizing them to:

(a) Advance funds of the association to preserve, protect, or purchase at any sale any asset in which the association has an interest.

(b) Sell, convey, lease, mortgage, or exchange any assets for other assets.

(c) Sell and dispose of any assets at public sale to the highest and best bidder or at private sale for the highest price obtainable.

(d) Accept withdrawable capital of the association to apply upon the purchase price of any assets, but only for such relative values as may be approved by the Director from time to time. Notice by single publication or by mailing, stating the time, place, and terms of the sale, shall be given to all holders of withdrawable capital prior to the sale.

(e) Pay out of the proceeds of liquidation all expenses and services necessary to the liquidation, and also compensation of the liquidators; but such compensation of the liquidators, exclusive of compensation for legal services and other specialized employment, shall not exceed in the aggregate three (3) per cent of the proceeds of liquidation. As amended by act approved June 4, 1957. L.1957, p. 433.

904. (p. 1286) § 9-4. *Election of Liquidators, Report, and Supervision.* Upon adoption of a plan of voluntary liquidation, the members shall proceed to elect (with cumulative voting permitted as in elections of directors) not more than three (3) liquidators, who shall have full power to execute the plan; and the procedure thereafter shall be as follows:

(a) A report of proceedings at the meeting of members, certified by the presiding officer of the meeting and attested by the secretary of the meeting, and setting forth the notice given and time of mailing thereof, the vote on the plan of voluntary liquidation, the total number of votes which all members of the association were entitled to cast thereon, and the names of the liquidators elected, shall be filed in triplicate with the Director, together with the plan.

(b) If the Director finds that the plan and proceedings are in accordance with this Act, that the bonds of the liquidators are sufficient, and that the plan is not unfair to any person

affected, he shall attach his certificate of approval to the plan and shall forward one copy to the liquidators, and in the case of an insured association, one copy to the insurance corporation.

(c) The plan shall become effective upon the recording of the Director's certificate of approval in the manner required by this act for the recording of articles of incorporation.

(d) The liquidation of the association shall be subject to the supervision and examination of the Director. As amended by act approved June 4, 1957. L.1957, p. 433.

905. (p. 1286) § 9-5. *Protection and Liquidation of Assets.* The liquidators are authorized to advance funds of the association and to take such other action as is advisable to preserve, protect, or purchase at any sale any real estate or other asset upon which the association may hold any lien or encumbrance or in which it may have an interest. The liquidators may sell, convey, lease, mortgage or exchange any assets so purchased or other assets; and in furtherance of the liquidation of the association, may sell and dispose of any of its assets at public sale to the highest and best bidder; or may sell any such assets at private sale for the highest price obtainable. No purchaser shall be required to ascertain the application of the purchase price.

906. (p. 1286) § 9-6. *Notice to File Claims.* The liquidators shall fix a time for all persons having claims against the association, other than as members thereof, to present such claims, and shall cause notice to be published, requiring all persons to present the claims on or before such date, and within five (5) days after the first publication shall mail a copy of such notice to each person whose name appears on the association's records as having a claim. Each claim shall be in writing and verified by the claimant or a duly authorized agent. A claim may be presented at any time on or before the date fixed in the published notice, but any claim not so presented

shall be barred. Upon the disallowance of any claim, the liquidators immediately shall notify the claimant of such fact, and the claimant may institute suit to establish such claim at any time before the final distribution.

907. (p. 1286) § 9-7. *Claims of Members.* Whether a member files or does not file a claim with respect to an interest which he has as such member, the liquidators shall determine from the records of the association the amount of such member's claim. Any such member may examine the association's records pertaining to his own claim. The records of the association shall be prima facie evidence of each such claim or interest, and no member shall be entitled to a greater claim or proportionate interest in the association unless and until the liquidators shall have agreed to a correction of the records pertaining to such claim or interest, or shall be ordered to correct such records by a court of competent jurisdiction. The liquidators shall require all members to present their certificates or account books, if any, for verification and endorsement upon payment of any liquidating dividend or distribution; and upon final distribution, such certificates or account books, if any, shall be surrendered to the liquidators.

908. (p. 1286) § 9-8. *Payments and Distribution.* Claims having a preference in law shall be given preference in payment; except that no payment of less than ten dollars ($10.00) need be made until final distribution. No distribution shall be made on claims for withdrawable capital until such preferred claims have been paid or provided for in full, or during the pendency of any suit unless sufficient funds are segregated to pay any judgment which may be rendered in such suit. Ratable payments and distributions on withdrawable capital may be made at any time after the time fixed for the presentment and allowance of claims has elapsed. Holders of permanent reserve capital, if any, shall participate in the liquidation of the remaining assets after payment or provision for payment has

been made in full to all creditors, holders of withdrawable capital, and any claims which the holders may have in the balance of any segregated reserves. Final distribution shall be made in accordance with the next succeeding section of this article. As amended by act approved July 11, 1957. L.1957, p. 2535.

909. (pp. 1286-87) § 9-9. *Final Distribution and Dissolution by Director.* When all assets have been liquidated and all claims and expenses have been paid, dissolution of the association shall be accomplished in the following manner:

(a) The liquidators shall file with the Director the duly verified final report of their acts and proposed final distribution.

(b) Upon the Director's approval of the final report, the liquidators shall publish notice of the proposed distribution, and shall allow any shareholder to examine the records of the association to ascertain his proper share of such distribution. Any shareholder who fails to commence, before the date fixed for final distribution, appropriate judicial proceedings to contest such distribution, shall be barred from contesting the same thereafter. The liquidators shall proceed to make final distribution on the date fixed therefor, except that such distribution shall be deferred until final disposition of any pending judicial action affecting the distribution, and payment of any judgment entered therein.

(c) When final distribution has been made, except as to any money due to but unclaimed by any creditor, shareholder, or other person, the liquidators shall deposit such unclaimed money with the Director, for payment to the person or persons entitled thereto upon application and proof of right as provided by law.

(d) The liquidators also shall deliver to the Director all books of account and other records of the association, for preservation for at least two (2) years and destruction thereafter as provided by law.

(e) Upon completion of the foregoing procedure, the liquidators shall be discharged; the Director shall issue a certificate of dissolution of the association and shall record same in the manner required by this act for the recording of articles of incorporation; and upon such recording, the dissolution shall be effective. As amended by act approved June 4, 1957. L. 1957, p. 433.

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ARTICLE 10. INVOLUNTARY LIQUIDATION

921. (p. 1287) § 10-1. *Director to Appoint Receiver.* If the Director, after taking custody of an association under the section of this act concerning Director's Authority to Take Custody,[1] finds that any one or more of the reasons for taking custody continues to exist through the period of his custody, then he shall appoint any qualified person, firm or corporation as receiver or co-receiver of such association or trust for the purpose of liquidation. In the case of an insured association, he may appoint the insurance corporation or its nominee as such receiver or as a co-receiver; and the insurance corporation may be permitted to serve without bond. The receiver shall take possession of and title to the books, records, and assets of every description of the association or trust. As amended by act approved June 4, 1957. L.1957, p. 433.

[1] Section 848 of this chapter.

922. (p. 1287) § 10-2. *Filing of Complaint by Attorney General.* After so appointing a receiver, the Director shall direct the Attorney General to file a complaint in equity in the name of the Director in the circuit or superior court of the county in which such association or trust is located and against the association or trustees or liquidators, as the case may be, for the orderly liquidation and dissolution of the association or trust and for an injunction restraining the officers, directors, trustees, or liquidators, from continuing the operation of the

association or trust. No complaint shall be filed nor shall other proceedings be commenced in any court for the dissolution or winding up of the affairs of the association or trust except in the name of and by authority of the Director represented by the Attorney General. As amended by act approved June 4, 1957. L.1957, p. 433.

923. (p. 1287) § 10-3. *Receiver's Powers; Court Supervision.* Upon order of the court in which the Director's complaint for dissolution and winding up of the affairs of the association has been filed, the receiver shall have the power and shall be charged with the duties and responsibilities as follows:

(a) To sell and compound all bad or doubtful debts on such terms as the court shall direct;

(b) To sell the real and personal property of the association on such terms as the court shall direct;

(c) To petition the court for authority to borrow money to protect assets or to facilitate liquidation and distribution, and to pledge assets as security therefor, which petition shall be heard by the court upon such notice to all parties in interest as the court shall direct, and such loans may be obtained and assets pledged as security therefor upon such terms and conditions as may be deemed expedient and necessary;

(d) To make and carry out agreements with the insurance corporation or with any other financial institution for the payment or assumption of the associations liabilities, in whole or in part, and to sell, convey, transfer, pledge or assign assets as security or otherwise, and to make guaranties in connection therewith. As amended by act approved June 4, 1957. L. 1957, p. 433.

924. (p. 1287) § 10-4. *Expenses of Custody and Receivership.* All expenses incurred by reason of the examination,

custody, and receivership, including compensation to such receiver, accountants, or clerical assistants, and reasonable solicitors' and attorneys' fees, approved by the Director or the court, shall be paid out of the assets of such association or trust. As amended by act approved June 4, 1957. L.1957, p. 433.

925. (p. 1287) § 10-5. *Notice to Creditors.* The receiver shall cause notice to be published calling on all persons who may have claims against such association or trust to present the same to such receiver and to make legal proof thereof, and the said claims shall be presented to the court, and the allowance or disallowance of such claims by the court in connection with said proceedings shall be deemed an adjudication in a court of competent jurisdiction. After the expiration of the time specified in such publication, the receiver shall file with the Director and with the clerk of the court a correct list of all creditors and all members of the association or beneficiaries of the trust, as shown by the books and records, who have not presented their claims, and the amount of their respective claims, after allowing all just credits, deductions and setoffs as shown by the books and records. Such claims so filed shall be deemed proven, unless objections are filed thereto by any parties interested therein within such time as shall be fixed by the court and such notice of application for adjudication of such claims shall be given as the court may direct. As amended by act approved June 4, 1957. L.1957, p. 433.

926. (pp. 1287-88) § 10-6. *Distribution by Receiver.* Claims having a preference in law shall be given preference in payment; except that no payment of less than ten dollars ($10.00) shall be made until final distribution. No distribution shall be made on claims for capital until such preferred creditors have been paid or provided for in full, or during the pendency of any suit unless sufficient funds are segregated to pay any judgment which may be rendered in such suit. At any time after

the expiration of the published claim date and from time to time, the receiver may make ratable distribution on all such claims as may have been proven to the satisfaction of the receiver, or adjudicated in a court of competent jurisdiction. Final distribution shall be made in accordance with the next succeeding section of this article.

927. (p. 1288) § 10-7. *Final Distribution and Dissolution by Court.* When all assets have been liquidated and all claims and expenses have been paid except for the final distribution, dissolution of the association shall be accomplished in the following manner:

(a) The receiver shall file with the court the final report of his acts and proposed final distribution.

(b) Upon the court's approval of the final report, the receiver shall give such notice, and thereafter shall make final distribution, in such manner as the court may direct.

(c) When final distribution has been made except as to any unclaimed money, the receiver shall deposit such unclaimed money with the Director and shall deliver to the Director all books of account and other records, in the manner and for the purpose prescribed in the section of this Act concerning Final Distribution and Dissolution by Director.[1]

(d) Upon completion of the foregoing procedure, and upon the petition of the Director (represented by the Attorney General) and the receiver, the court may find that the association or trust should be dissolved; and after such publication of notice of dissolution as the court may direct, the court may enter a decree of dissolution. As amended by act approved June 4, 1957. L.1957, p. 433.

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[1] Section 909 of this chapter.

APPENDIX I

AMENDED FIRST CROSS-COMPLAINT OF THE RECEIVERS

(Filed September 25, 1969)

Now comes the Defendant and Cross-Plaintiff, City Savings Association, by its Receivers, Leonard B. Ettelson and William J. Friedman, by and through their counsel, Don H. Reuben, and complains against Cross-Defendants Joseph E. Knight, Justin Hulman, Chris Stolfa and Donald Swope as follows:

1. From February, 1961 through December, 1961, Defendant Joseph E. Knight was Assistant Director of Financial Institutions for the State of Illinois. From January, 1962 through 1965, said Cross-Defendant Knight was Director of Financial Institutions for the State of Illinois. As such, Cross-Defendant Knight was vested with the responsibility of making annual examinations into the affairs of every Illinois Savings and Loan Association for the purpose of establishing that the affairs of each state-chartered institution were being conducted in accordance with the provisions of the Illinois Savings and Loan Act.

2. From 1959 through 1962, Cross-Defendant Chris Stolfa was the Supervisor of Savings and Loan Associations for the State of Illinois. During 1963, Defendant Donald Swope was the acting Supervisor of Savings and Loan Associations. During 1964, Cross-Defendant Justin Hulman was the Supervisor of Savings and Loan Associations. Cross-Defendants Stolfa, Swope and Hulman were appointed by and responsible to the Director of Financial Institutions and administratively responsible for all savings and loan associations in the State of Illinois. As such, it was their duty to insure that all savings and loan associations were operated and conducted in accordance with the Illinois Savings and Loan Act.

3. During the period from 1959 through June of 1964, the affairs of Defendant City Savings Association were manifestly not being conducted in accordance with the provisions of the Illinois Savings and Loan Act. Specifically, City Savings Association during this period loaned over $21,000,000—approximately 74% of its assets—purportedly secured by the alleged collateral of two proposed developments, the so-called "Apple Orchard" and "Howie in the Hills" projects. At all relevant times, the mortgaged realty in question was worth only a small fraction of the amounts loaned by City Savings. Many other acts of misconduct occurred at City Savings Association, such as self dealing, questionable advertising and premium practices, etc. All of these irregularities rendered City Savings Association in grossly unsound condition; its capital was substantially impaired and it was in law insolvent. Ultimately, albeit belatedly, custody of City Savings Association was taken on or about June 26, 1964, by Director Knight and Supervisor Hulman pursuant to *Ill.Rev.Stat.*, Ch. 32, § 848.

4. The extent of the flagrant acts of mismanagement that occurred at City Savings between 1959-1964 is readily discerned by a reference to City Savings' collateral position in the Apple Orchard and Howie in the Hills projects. A recent appraisal of the true value of the Apple Orchard and Howie in the Hills Subdivision properties mortgaged to City Savings is $6,391,751.31. The loss that City Savings will likely suffer as a result of its investment therein is approximately $14,110,711.00.

5. Cross-Plaintiff asserts that the affairs of City Savings were being so grossly mismanaged during the years 1959-1964 that no reasonable person could have made any kind of examination (even of a cursory nature) of City Savings Association and reasonably have believed City Savings to be sound or that the management should not be removed. Thus, during the period from 1959-1964, there were either no meaningful examinations whatsoever by the Director or, in the alternative, examinations in fact were made but the truth about the institution's dire condition was ignored or concealed. Nor was there any proper supervision by Cross-Defendant Stolfa, Swope and Hulman of the affairs of City Savings Association from 1959-1964. In either event, whether no supervision or examinations took place, or the results of the supervision and examinations were ignored or concealed, Cross-Defendants Knight, Stolfa, Swope and Hulman have violated official duties owing to City Savings Association, its members and creditors and are liable to said City Savings Association for damages arising therefrom.

6. As a proximate result of the aforementioned breaches of official duty to City Savings Association, its creditors and members, by Cross-Defendants Knight, Stolfa, Swope and Hulman, City Savings Association has suffered damages in the amount of $14,110,711.

7. Cross-Defendants Knight, Stolfa, Swope and Hulman have given bonds conditioned upon the faithful performance of their official duties, and the aforementioned violations of their official duties are breaches of the conditions thereof.

Wherefore, City Savings Association seeks judgment against Cross-Defendants Knight, Stolfa, Swope and Hulman for its damages, $14,110,711; Cross-Plaintiff prays therefor and for such other relief as is appropriate.

Count II

Now comes the Defendant and Cross-Plaintiff, City Savings Association, by its Receivers, Leonard B. Ettelson and William J. Friedman, by and through their counsel, Don H. Reuben, and complains against Cross-Defendants Joseph E. Knight and Justin Hulman as follows:

1. During the year 1964, Cross-Defendant Joseph E. Knight was the Director of Financial Institutions of the State of Illi-

nois. Among his duties as Director was his duty to supervise state-chartered savings and loan institutions.

2. During the year 1964, Cross-Defendant Justin Hulman was Supervisor of Savings and Loan Associations in the Department of Financial Institutions. Cross-Defendant Hulman was appointed by and responsible to Director Knight.

3. On or about June 26, 1964, Director Knight, acting through and by Supervisor Hulman, took custody of the assets of City Savings Association upon a determination that it was the Director's statutory duty to do so. *Ill.Rev.Stat.* 1963, Ch. 32, §848. Under Illinois law, the cross-defendants in their official capacity were required to take custody of City Savings Association due to the following circumstances: Through misappropriation and mismanagement, the officers and directors of City Savings Association had impaired the capital position of the institution, making the seizure of custody necessary for the protection of its members and creditors. A copy of the Notice pursuant to which Cross-Defendant Knight took custody is attached hereto as Exhibit "A".

4. The statutes of the State of Illinois allowed a restoration by the State of custody of a savings and loan association to the institution's management only if all the causes for the seizure had been eliminated. The relevant statute (*Ill.Rev.Stat.* 1963, Ch. 32, §854) provided:

> "Redelivery of Possession. If after examination of the association and consideration of all conditions affecting its affairs, the Director finds that the cause or causes for taking custody have been removed, he shall relinquish custody of the association and redeliver the same and all assets, books and records thereof to the directors of the association or to the trustees or liquidators qualified to accept the same."

In the event that the causes for the seizure were not eliminated, Illinois law required the appointment of a receiver and liquidation of the institution under the aegis of a court of equity. *Ill. Rev.Stat.*, 1963, Ch. 32, §§ 921-923.

5. In the instant case, at no time after seizure by the Cross-Defendants were the reasons for the seizure of City Savings eliminated; to the contrary, they existed in whole or in part from the date of seizure through September 10, 1964. Nevertheless, on or about September 10, 1964, at a time when the causes for taking custody persisted and when, therefore, it was the statutory duty of the Director of Financial Institutions to appoint a receiver and commence involuntary liquidation proceedings, Cross-Defendants Knight and Hulman relinquished control of the assets of City Savings Association to so-called "voluntary liquidators"' selected by the Association's management with the consent and cooperation of Cross-Defendants Knight and Hulman.

6. The so-called voluntary liquidators committed many acts of mismanagement while they had possession and control of the assets of City Savings Association, including but not limited to the payment of excessive costs and fees, failure to notify depositors as to the course of the liquidation, failure to keep adequate records or even take any inventory of the assets of City Savings Association and failure to seek to recover hidden assets of City Savings Association. Various other acts of mismanagement took place during the course of the liquidation which cross-plaintiff, through its Receivers, will attempt to uncover by means of discovery.

7. By the aforementioned unlawful transfer of the assets of City Savings Association to so-called "voluntary liquidators", Cross-Defendants Joseph E. Knight and Justin Hulman flagrantly breached statutory and fiduciary duties owing to City Savings Association, its members and creditors.

8. Because of the aforementioned unlawful transfer of the assets of City Savings Association to so-called "voluntary liquidators" by Cross-Defendants Hulman and Knight, and the waste

and mismanagement that occurred as a direct result thereof, City Savings Association has suffered damages in the amount of $20,000,000.

9. Cross-Defendants Knight and Hulman have given bonds conditioned upon the faithful performance of their official duties; the aforementioned violations of their official duties are breaches of the conditions thereof.

Wherefore, City Savings Association seeks judgment against Cross-Defendants Joseph E. Knight and Justin Hulman for its damages, $20,000,000. Cross-Plaintiff prays therefor and for such other relief as is appropriate.

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APPENDIX J

ANSWER

Of First National Bank and Trust Company in Alton, Executor of the Estate of Joseph E. Knight, Deceased, to the Amended First Cross-Complaint of the Receiver

(Filed April 24, 1975)

The First National Bank and Trust Company in Alton, Executor of the Estate of Joseph E. Knight, Deceased, cross-defendant to the Amended First Cross-Complaint of the Receiver, hereby answers said cross-complaint, in accordance with the numbered paragraphs thereof as follows:

Count I

1. First Defense: Admits that Joseph E. Knight, Deceased was Assistant Director of Financial Institutions and then was Director of Financial Institutions, respectively, for the State of Illinois; is without knowledge or information sufficient to form a belief as to the truth of the remaining averments of said paragraph 1.

2. Is without knowledge or information sufficient to form a belief as to the truth of the averments in paragraphs 2, 3, 4, 7, and denies 5 and 6, respectively, of said Count 1.

3. Second Defense: Further answering Count I, this cross-defendant says that the said Joseph E. Knight, as a state officer, had immunity from personal liability for acts of judgment performed within the scope of his authority without corruption, and that his actions and inactions complained of in said Count all involved official acts of judgment and discretion concerning which no corruption is alleged.

4. Third Defense: Further answering Count I, this cross-defendant says that the said Joseph E. Knight was not liable for the acts or defaults of his subordinates in the discharge of their public duties.

Count II

1. First Defense: Admits that Joseph E. Knight, Deceased, was Assistant Director of Financial Institutions, and then was Director of Financial Institutions, respectively, for the State of Illinois; is without knowledge or information sufficient to form a belief as to the truth of the remaining averments of said paragraph 1.

2. Admits the accuracy of the statutory quotation in paragraph 4. As to the remainder of Count II, is without knowledge or information sufficient to form a belief as to the truth of the averments in paragraphs 2, 3, 6, and denies paragraphs 4, 5, 7, 8 and 9, respectively of said Count II.

3. Second Defense: This cross-defendant incorporates by reference its Second Defense to Count I as its Second Defense to Count II; and states that the transfer of the assets of City Savings Association to voluntary liquidators was pursuant to a Plan of Liquidation drafted by the staff of the Illinois Attorney General designated by law as the legal advisor to the Director of Financial Institutions.

4. Third Defense: Further answering Count II this cross-defendant says that the alleged statutory duties which the said Joseph E. Knight is charged with violating are duties owed to the State of Illinois, and not to private individuals such as plaintiffs and cross-plaintiffs.

5. Fourth Defense: Further answering Count II, this cross-defendant says that the alleged cause of action is barred because the City Savings Association and its members and creditors failed to follow the procedures provided by the Illinois Savings and Loan Act and, in particular, Section 860 thereof (32 Ill. Rev. Stat. Section 860).

APPENDIX K

Excerpt from Federal Rules of Civil Procedure:

Rule 9. Pleading Special Matters

. . .

(b) *Fraud, Mistake, Condition of the Mind.* In all averments of fraud or mistake, the circumstances constituting fraud or mistake shall be stated with particularity. Malice, intent, knowledge, and other condition of mind of a person may be averred generally.

APPENDIX L

Excerpts from Illinois Financial Code.

Ill. Rev. Stat. 1963, Vol. 3, Ch. 127, p. 393, provides in part:

63b25. *Powers and duties.*] § 6. In addition to the duties imposed elsewhere in this Act, the Department shall have the following powers:

(1) To exercise the rights, powers and duties vested by law in the Auditor of Public Accounts under "An Act to revise and codify the laws in relation to savings and loan associations and to provide penalties for the violation thereof, and to repeal an Act therein named," approved July 5, 1955, and as may be from time to time hereafter amended.[1]

(2) To exercise the rights, powers and duties vested by law in the Auditor of Public Accounts under "an Act to provide for and regulate the administration of trusts by trust companies," approved June 15, 1887, as amended,[2] and as may be from time to time hereafter amended.

(3) To exercise the rights, powers and duties vested by law in the Auditor of Public Accounts under "An Act to revise the law in relation to credit unions and to repeal a certain act therein named," approved June 16, 1953, as amended,[3] and as may be from time to time hereafter amended.

(4) To exercise the rights, powers and duties vested by law in the Auditor of Public Accounts under "An Act to provide for the incorporation, management and regulation of pawners' societies and limiting the rate of compensation

to be paid for advances, storage and insurance on pawns and pledges and to allow the loaning of money upon personal property," approved March 29, 1899, as amended,[4] and as may be from time to time hereafter amended.

(5) To exercise the rights, powers and duties vested by law in the Auditor of Public Accounts under "An Act in relation to the definition, licensing and regulation of community currency exchanges and ambulatory currency exchanges, and the operators and employees thereof, and to make an appropriation therefor, and to provide penalties and remedies for the violation thereof," approved June 30, 1943, as amended,[5] and as may be from time to time hereafter amended.

(6) To exercise the rights, powers and duties vested by law in the Auditor of Public Accounts under "An Act in relation to the buying and selling of foreign exchange and the transmission or transfer of money to foreign countries," approved June 28, 1923, as amended,[6] and as may be from time to time hereafter amended.

(7) To exercise the rights, powers and duties vested by law in the Auditor of Public Accounts under "An Act to provide for and regulate the business of guaranteeing titles to real estate by corporations," approved May 13, 1901, as amended,[7] and as may be from time to time hereafter amended.

(8) To exercise the rights, powers and duties vested by law in the Department of Insurance under "An Act to define, license, and regulate the business of making loans of eight hundred dollars or less, permitting an interest charge thereon greater than otherwise allowed by law, authorizing and regulating the assignment of wages or salary when taken as security for any such loan or as consideration for a payment of eight hundred dollars or less, providing penal-

ties, and to repeal Acts therein named," approved July 10, 1935, as amended,[8] and as may be from time to time hereafter amended.

(9) To exercise the rights, powers and duties vested by law in the Auditor of Public Accounts under "An Act to provide for the chartering of corporations under the supervision of the Auditor of Public Accounts to guarantee the members of credit unions against loss on share accounts and to define the powers of such corporations," approved July 13, 1955,[9] and as may be from time to time hereafter amended. As amended by act approved Aug. 7, 1963. L. 1963, p. —, S.B.No. 1018.

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63b27. *Other duties of Director.*] § 8. The Director shall direct and supervise all Department administrative and technical activities, in addition to the dtuies imposed upon him elsewhere in this Code, and shall:

(1) Apply and carry out this Code and the laws and all rules adopted in pursuance thereof.

(2) Appoint, subject to the provisions of the Personnel Code, such employees of the Department and such experts and special assistants as may be necessary to carry out effectively the provisions of this Code.

(3) Foster and develop programs with financial institutions, for the best interests of these institutions, their services and the people of the State of Illinois.

(4) Attend meetings of the Advisory Boards created by laws relating to financial institutions.

(5) Making continuous studies and report his recommendations to the Governor for the improvement of the Department.

(6) Make an annual report regarding the work of the Department and such special reports as he may consider desirable to the Governor, or as the Governor may request.

(7) Perform any other lawful acts which he may consider necessary or desirable to carry out the purposes and provisions of this Law. Effective July 1, 1958.

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(p. 394)

63 b 35. *Appointment of supervisors.* Section 16. There shall be a Supervisor of Banks, a Supervisor of Savings and Loan Associations, a Supervisor of Consumer Finance Businesses, a Supervisor of Currency Exchanges, and a Supervisor of Credit Unions. The Supervisors shall be appointed by and responsible to the Director and shall be administratively responsible within the Department for the financial institutions to which their appointments pertain. Effective January 1, 1958.